

**PRESIDENT'S FISCAL YEAR 2003 BUDGET WITH
TREASURY SECRETARY O'NEILL**

HEARING
BEFORE THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

FEBRUARY 5, 2002

Serial No. 107-54

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

79-512

WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON WAYS AND MEANS
BILL THOMAS, California, *Chairman*

PHILIP M. CRANE, Illinois	CHARLES B. RANGEL, New York
E. CLAY SHAW, JR., Florida	FORTNEY PETE STARK, California
NANCY L. JOHNSON, Connecticut	ROBERT T. MATSUI, California
AMO HOUGHTON, New York	WILLIAM J. COYNE, Pennsylvania
WALLY HERGER, California	SANDER M. LEVIN, Michigan
JIM McCRERY, Louisiana	BENJAMIN L. CARDIN, Maryland
DAVE CAMP, Michigan	JIM McDERMOTT, Washington
JIM RAMSTAD, Minnesota	GERALD D. KLECZKA, Wisconsin
JIM NUSSLE, Iowa	JOHN LEWIS, Georgia
SAM JOHNSON, Texas	RICHARD E. NEAL, Massachusetts
JENNIFER DUNN, Washington	MICHAEL R. McNULTY, New York
MAC COLLINS, Georgia	WILLIAM J. JEFFERSON, Louisiana
ROB PORTMAN, Ohio	JOHN S. TANNER, Tennessee
PHIL ENGLISH, Pennsylvania	XAVIER BECERRA, California
WES WATKINS, Oklahoma	KAREN L. THURMAN, Florida
J.D. HAYWORTH, Arizona	LLOYD DOGGETT, Texas
JERRY WELLER, Illinois	EARL POMEROY, North Dakota
KENNY C. HULSHOF, Missouri	
SCOTT McINNIS, Colorado	
RON LEWIS, Kentucky	
MARK FOLEY, Florida	
KEVIN BRADY, Texas	
PAUL RYAN, Wisconsin	

Allison Giles, *Chief of Staff*
Janice Mays, *Minority Chief Counsel*

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

Advisory of January 29, 2002, announcing the hearing	2
WITNESS	
U.S. Department of the Treasury, Hon. Paul O'Neill, Secretary	11
SUBMISSION FOR THE RECORD	
National Society of Accountants, Alexandria, VA, statement	76

**PRESIDENT'S FISCAL YEAR 2003 BUDGET
WITH TREASURY SECRETARY O'NEILL**

TUESDAY, FEBRUARY 5, 2002

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 10:08 a.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
January 29, 2002
No. FC-10

CONTACT: (202) 225-1721

Thomas Announces a Hearing on the President's Fiscal Year 2003 Budget with Treasury Secretary O'Neill

Congressman Bill Thomas (R-CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on President Bush's fiscal year 2003 budget proposals within the jurisdiction of the Committee. **The hearing will take place on Tuesday, February 5, 2002, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from the Honorable Paul O'Neill, Secretary, U.S. Department of the Treasury. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

On January 29, 2002, President George W. Bush will deliver his State of the Union address, in which he is expected to outline numerous budget and tax proposals. The details of these proposals are expected to be released on February 4, 2002, when the President is scheduled to submit his fiscal year 2003 budget to the Congress. In recent weeks, the President has reaffirmed his commitment to returning our economy to prosperity as soon as possible by offering tax relief that will promote economic growth. The President's proposals include accelerated depreciation of investment, reduction of marginal tax rates, reform of the corporate alternative minimum tax, and tax credits for individual health insurance.

In announcing the hearing, Chairman Thomas stated, "The President has advanced several important proposals within the jurisdiction of the Committee on Ways and Means such as on economic stimulus and tax credits that expand health insurance coverage. I look forward to receiving the President's budget and discussing his proposals with Secretary O'Neill."

FOCUS OF THE HEARING:

The Committee will receive testimony on the President's fiscal year 2003 budget proposals from Secretary O'Neill. The Secretary is expected to discuss the details of the President's proposals that are within the Committee's jurisdiction.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to "hearingclerks.waysandmeans@mail.house.gov," along with a fax copy to 202/225-2610 by the close of business, Tuesday, February 19, 2002. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the full Committee in room 1102 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse unopened and unsearchable deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to "hearingclerks.waysandmeans@mail.house.gov," along with a fax copy to 202/225-2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov/>.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman THOMAS. Good morning. And welcome back, everyone. I do want to indicate that, not with us, Clay Shaw, who is not going to be with us for a portion of time because of a medical reasons in the family. Paul Ryan is not with us because he and his wife Janna had a baby girl, Elizabeth Ann, born on 02/02/02, which that he quite properly is there instead of here. So if any of you were concerned about Paul Ryan's priorities, I believe he is a dedicated Member, but he is a dedicated father more.

The President's fiscal year 2003 budget plan is, above all else, I think on target for the times we are living in. And because of the considerable foreign and domestic challenges that our Nation now faces, a wealth of unanticipated circumstances and fiscal demands has forced us to change our thinking just since September 11th. We

have been attacked as a Nation, and I believe we must respond as a Nation. And that has fundamentally altered the physical landscape.

The President's proposal is part of a strategy to protect our country and citizens. I think it is quite right that for now, it cannot be business as usual. President Bush has presented us with a sound fiscal blueprint, its underlying growth assumptions are measured and reasonable. Its fundamental and concise goals, win the war, protect the homeland and revive the economy, make sense in our current extraordinary circumstances. Those three factors, win the war, protect the homeland, revive the economy, I believe fundamentally define the President's 2003 budget.

Maintaining the viability of our domestic economic life demands action. The President's agenda, as he said in the State of the Union, can be summed up with one word: jobs. The war against terrorism must and will shape the fiscal agenda for the next at least several years. Yet ensuring economic security and job creation matter enormously to people across this country. People need to know that they will have a paycheck if not now, soon. The President's proposals constitute a sensible fiscal strategy that will serve as a platform for strong and sustained economic growth.

As we know, the economy has been in recession since March of last year. We believe now there is more good news than bad. Unemployment hasn't risen as much as had been feared. Production of durable goods, at least on the short-term measurables, is on the rise. Fourth quarter GDP or gross domestic product came in a bit stronger than expected.

Indeed the Chairman of the Federal Reserve signaled his growing confidence that recovery is underway based upon statements that were made in front of Senate Committees last week.

Those who argue that last spring's tax bill has contributed to the recession, in my opinion, are frankly out of touch with the facts. Most of that law hasn't yet kicked in. The laws of economics don't get repealed when disaster strikes. Cutting taxes still generates economic growth and raising them in a recession still spells trouble.

Lower taxes don't just put money in people's pockets. They help fund the business investment, innovation and expansion that must form the backbone of a long-term economic revitalization. They encourage further competition and the return of venture capital to the marketplace.

Against the backdrop of a recovering economy, the need for economic stimulus is perhaps less obvious than in the first months after September 11th. The House acted in October to pass a stimulus package, again in December in a slightly modified form. The Senate has yet to act. And based upon the latest headlines, it seems as though there may be an attempt to make sure that the Senate cannot complete a package which reflects the will of the Senate.

It also, I don't believe, means that a stimulus package is no longer necessary. Part of the comments that I will direct toward the Secretary would be his feeling about the need for a stimulus package. Perhaps in October, we would have been a bit bolder and stronger, but even today, perhaps there may need to be a package.

The aftermath of September 11th has, to a degree, shaken the people's confidence in their economic future. Markets are not yet convinced that we have the right plan. We should not be shy in insisting on action to ensure the durability of economic recovery. In the face of current danger, waiting to see what happens is rarely the right strategy.

Since we were last in session, a number of events have occurred that I believe forces us to shape the Committee's hearing agenda as well as it required a reshaping of the President's budget. On February 13th I want to announce that we will be holding a hearing focusing on health insurance tax credits for the uninsured. And beginning on February 26th, in consultation with the Ranking Member, I want to schedule a series of hearings. This Committee, as well as other committees, will have responsibilities focused on the question of retirement security. And this Committee, as it almost always does, should not react to a single specific circumstance but rather look at the broad underlying fundamentals as to whether or not they need correction.

So perhaps we could start on February 26th looking at defined contribution pensions, the question of individual retirement savings, 401(k)s and that sort. We would then move to a defined benefit plan hearing focusing on what are called in the steel industry "legacy costs," as well as other defined benefit plans and the veracity of the system that we have constructed in the past to sustain those programs notwithstanding the failure of companies, leading to a series of hearings on Social Security solvency and reform for the 21st century.

So we will have an aggressive agenda out in front of us addressing somewhat immediate concerns, but hopefully placing them in the context of long-term fundamental adjustments to the system.

Mr. Secretary, it is a pleasure to have you with us. And prior to asking you to speak to us for your assigned period of time, the Chair would now recognize the Ranking Member, the gentleman from New York.

[The opening statement of Chairman Thomas follows:]

Opening Statement of the Hon. Bill Thomas, Chairman, Committee on Ways and Means, and a Representative in Congress from the State of California

Good morning. And welcome back, everyone. The President's fiscal year 2003 budget plan is, above all else, on target for the times we are living in. And because of the considerable foreign and domestic challenges that our nation now faces, a wealth of unanticipated circumstances and fiscal demands has forced us to change our thinking just since September 11th. We have been attacked as a nation, and I believe we must respond as a nation. And that has fundamentally altered the fiscal landscape.

The President's proposal is part of a strategy to protect our country and citizens. I think it is quite right that for now, it cannot be business as usual. President Bush has presented us with a sound fiscal blueprint. Its underlying growth assumptions are measured and reasonable. Its fundamental and concise goals—win the war, protect the homeland and revive the economy—make sense in our current extraordinary circumstances. Those three factors—win the war, protect the homeland, revive the economy—I believe fundamentally define the President's 2003 budget.

Maintaining the viability of our domestic economic life demands action. The President's agenda, as he said in his State of the Union address, can be summed up with one word: jobs. The war against terrorism must and will shape the fiscal agenda for the next at least several years. Yet ensuring economic security and job creation matter enormously to people across this country. People need to know that they will have a paycheck—if not now, soon.

The President's proposals constitute a sensible fiscal strategy that will serve as a platform for strong and sustained economic growth. As we know, the economy has been in recession since March of last year. We believe now there is more good news than bad. Unemployment hasn't risen as much as had been feared. Production of durable goods, at least on the short-term measurables, is on the rise. Fourth quarter GDP came in a bit stronger than expected. Indeed, the chairman of the Federal Reserve signaled his growing confidence that recovery is underway in his statement before a Senate committee last week.

Those who argue that last spring's tax bill has contributed to the recession, in my opinion, are frankly out of touch with the facts. Most of that law hasn't yet kicked in. The laws of economics don't get repealed when disaster strikes. Cutting taxes still generates economic growth and raising them in a recession still spells trouble.

Lower taxes don't just put money in people's pockets. They help fund the business investment, innovation and expansion that must form the backbone of a long-term economic revitalization. They encourage further competition and the return of venture capital to the marketplace.

Against the backdrop of a recovering economy, the need for economic stimulus is perhaps less obvious than in the first months after September 11th. This House acted in October to pass a stimulus package, and again in December in a slightly modified form. The Senate has yet to act. And based upon the latest headlines, it seems as though there may be an attempt to make sure that the Senate cannot complete a package that reflects the will of the Senate.

I don't believe that a stimulus package is no longer necessary. Part of the comments that I will direct towards the Secretary would be his feeling about the need for a stimulus package. Perhaps in October, we would have been a bit bolder and stronger, but even today, perhaps there may need to be a package.

The aftermath of September 11th has, to a degree, shaken the people's confidence in their economic future. Markets are not yet convinced that we have the right plan. We should not be shy in insisting on action to ensure the durability of economic recovery. In the face of current danger, waiting to see what happens is rarely the right strategy.

Since we were last in session, a number of events have occurred that I believe force us to shape the committee's hearing agenda, as well as it required a reshaping of the President's budget. I want to announce that on February 13th we will be holding a hearing focusing on health insurance tax credits for the uninsured. And beginning on February 26th, in consultation with the ranking member, I want to schedule a series of hearings. This committee, as well as other committees, will have responsibilities focused on the question of retirement security. And this committee, as it almost always does, should not react to a single specific circumstance but rather look at the broad underlying fundamentals as to whether or not they need correction.

So perhaps we could start on February 26th by looking at defined contribution pensions, the question of individual retirement savings, 401(k)s. We would then move to a defined benefit plan hearing, focusing on what are called in the steel industry "legacy costs." We would also look at other defined benefit plans and the veracity of the system that we have constructed in the past to sustain those programs, notwithstanding the failure of companies. This would lead to a series of hearings on Social Security solvency and reform for the 21st century.

So we will have an aggressive agenda out in front of us, addressing somewhat immediate concerns but hopefully placing them in the context of long-term fundamental adjustments to the system.

Mr. Secretary, it is a pleasure to have you with us. And prior to asking you to speak to us for your assigned period of time, the Chair would now recognize the ranking member, the gentleman from New York.

Mr. McDERMOTT. Mr. Chairman, may I ask just a question. Are your remarks written so we could all have a copy?

Chairman THOMAS. Some of them are, some of them are not. But I will get them to you since they are now done.

Mr. McDERMOTT. I think they are very important remarks for us to sort of hold. I would like to have a copy, if I may. Thank you.

Mr. RANGEL. Mr. Chairman, I cannot tell you how excited I am about the consultations that we will have as relates to anything but, more specifically, the retirement security. Am I to read into that that Enron will also be a part of our discussions at these hearings as relates to 401(k)?

Chairman THOMAS. I tell the gentleman, obviously, that is the specific example, but I think we need to look at the broader consequences and, in fact, the market reflecting the question of debt versus equity and instruments utilized in that underlying some of the concerns about the retirement package.

Mr. RANGEL. Well, we look forward to working with you on this and other subjects.

Mr. Secretary, again, welcome to our Committee, and thank you so much for your courteous call to me yesterday.

This Committee has the responsibility of maintaining a sound tax policy for our Nation during times of peace and war, and we will be very carefully following where we go in the budget situation because the war and the popularity of the President has dramatically changed the political tone of the Members on both sides of the aisle.

There is no question in my mind that all Americans would want the President and this Congress to spend whatever is necessary in order to protect our national security. In the President's State of the Union message, however, the question as to the extent we are being threatened was not as clear as the attack on the World Trade Center. That is to say, that America recognizes when it is being attacked. America recognized our search for Usama bin Laden, and America stands ready to support our men and women to do what has to be done.

The President seems to have expanded the threat to the United States by the evil axis. Most of us haven't the slightest clue of what that means or the extent that we have to be prepared or the extent that this will be included in our defense budget, and we don't know whether the list will ultimately include Somalia or Libya. But we do know one thing, that we have to take this one step at a time when we are talking about the budget.

Because there are some ongoing things that are going to happen, regardless of how the threats to our national security appear to be in the President's eye and as explained to us, I assume, at some later date. I am talking specifically about our Social Security system.

Some of us believe that, with the majority party, the system is not a very popular system, nor is Medicare a popular system. It bothers us to see that the money that we are spending now for defense is coming out of the funds that people are paying in order to put into the Social Security system. The rhetoric that we have had, lockboxes and strongboxes and budget restrictions, has now been thrown to the wind because it is wartime.

But as we look at the numbers that are given to us by the Congressional Budget Office (CBO), we see a large amount of the surplus being wiped away now and in the immediate future, and not so much because of our war expenses but a large part because of our tax cuts.

I think that all of us share the direction that the President is taking in terms of wanting to reduce the tax liability on all of our citizens. We may differ as to the income tax groups that receive the benefits at the expense of lower income workers, but that is a political question that can be debated. The real question, however, is that if we project tax cuts, you know, even past 2011, and we have to rely on the rosy scenarios that are given to us by economists with two hands, it just seems to us that we cannot feel that secure about getting back to the surpluses that we have recently enjoyed and the security that we had in knowing that people would retire and have the funds there.

Can you hear me? Anyway, I will just conclude by saying that it looks as though—and I hope that people in the Administration would put Social Security back on the priority list.

The last we heard, the President appointed a bipartisan commission that agreed with him in terms of where he would like to see the Social Security go. But the commission reported, don't do anything. They didn't say, don't do it because it is an election year, but that is the way we think. 2002, don't do anything there.

Then I think it said it would take something like a trillion dollars to make the transition, which Mr. Clay and Mr. Matsui agree that it would take that.

I do hope that as we talk about the war effort that we also talk about the security of our older folks and health care and give us some assurances that we are not just dealing with speculations but we are dealing with taxpayers' money. No one is more patriotic than me, but I don't know how far this thing is going.

I listen to Ms. Condoleezza Rice and she said, listen closely, because the President will be sharing with us what he meant by the evil axis. Well, I got my own evil axis I would like to slip in there, too, if the President has got a list. But we will see where it goes. But, right now, we support the President. We support the war effort.

We thank you so much for coming to share your views with us. [The opening statements of Mr. Rangel and Mr. Crane follow:]

**Opening Statement of the Hon. Charles B. Rangel a Representative in
Congress from the State of New York**

This committee has the responsibility of maintaining a sound tax policy for our nation in peace and war. And we will be very carefully following where we go in the budget situation because the war and the popularity of the President has dramatically changed the political tone of members on both side of the aisle.

There is no question in my mind that all Americans would want the President and this Congress to spend whatever is necessary to protect our national security. Since the President's State of the Union address, however, there is a question as to extent that we are being threatened. It is not as clear as the attack on the World Trade Center. That is to say that America recognizes when it is being attacked and recognizes that Osama Bin Laden was involved and America stands ready to support our men and women to do what has to be done.

Our President seems to have extended the threat to the United States to the "evil axis." Most of us do not have a clue as to what that means or the extent to which we have to be prepared, or the extent to which it would be included in the defense budget. And we do not know if ultimately the list will include Somalia or Libya, but we do know one thing. We have to take this one step at a time when talking about the budget because there are some ongoing things that are going to happen and, regardless of the threats to our national security, appear to be in the President eye and explained to us I assume at some later date.

I am talking specifically about our Social Security system. Some of us believe that, with the majority party, the system is not a popular system. Nor is the Medicare system popular. It bothers us to see that the money that we are now spending for defense is coming out of the funds that people are paying into the Social Security system.

The rhetoric that we have had with lockboxes and strong boxes and budget restrictions now have been thrown to the wind because it is wartime. But, as we look at the numbers that have been given to us by the Congressional Budget Office, we see a large amount of the surplus being wiped away now and in the immediate future and not so much because of our war expenses, but in large part because of our tax cuts. I think that all of us hear the direction that the President is taking in terms of wanting to reduce the tax liability on all of our citizens. We may differ on the income tax group that receives the benefits at the expense of lower income workers, but that is a political question that has to be debated.

The real question, however, is: if we are projecting tax cuts even past 2011 and we have to rely on the scenario given to us by economists, it just seems to us that we can not feel that secure about taxes and surpluses that we have enjoyed and the security that we had knowing that people would retire and have the funds there.

I conclude by saying that I hope that those in the administration would put Social Security back on the priority list. The last we heard the President appointed a bipartisan commission that concurred with him on where he would like the Social Security to go. But the commission reported, do not do anything. They did not say do not do it because it is an election year, but that is the way we think: 2002, do not want to do anything there. Then, I think it said something like it would take a trillion dollars to make the transition, which Mr. Shaw and Mr. Matsui agree that it would take that. And I do hope that, as we talk about the war effort, that we talk about the security of our own approach to health care and give us some assurances that we are not just dealing with speculation but we are dealing with taxpayers money.

No one is more patriotic than me, but I do not know how far this thing is going? I listened to Ms. Condoleezza Rice and she said that, listen closely because the President will be explaining what he means by the "evil axis." Well, I have got my own evil axis and I can add to it if the President has a list. But we will see where it goes. For now, we support the President, we support the war effort, and we thank you so much for coming to share your views with us.

Opening Statement of the Hon. Philip M. Crane a Representative in Congress from the State of Illinois

Mr. Chairman, I want to thank you for holding this very important hearing on the President's budget proposal. I also want to thank Secretary O'Neill for appearing on behalf of the Bush Administration today.

Today we stand at a historic intersection in the future of our great nation. The events of September 11th have reshaped our priorities. Our Nation is at war. We must focus on winning the war on terrorism abroad and protecting our citizens at home. At the same time we must continue the policies begun by the Bush Administration to make sure our economy is on sound footing and to create jobs. I am pleased that President Bush's budget strikes a balance in achieving both of these goals. And while I would like to see more in the way of tax relief for hard-working Americans, the tax relief provided in this budget is a great start.

The President has put forward a budget that includes several items I have championed for nearly a decade. In particular, I have championed legislation to allow nonitemizers to deduct their charitable contributions and to permit tax-free withdrawals from IRAs for charitable contributions and I am glad to see President Bush included similar provisions in his budget. The President has called for greater involvement by citizens in charitable endeavors. While we should all strive to give time and money to such efforts, anything we can do through tax relief to help Americans move money to charitable organizations is a step in the right direction.

Likewise, I have long supported the idea that Americans, who are beneficiaries of an employer-sponsored flexible spending arrangement, be able to rollover their unused funds for future health care needs. Over time, this will reduce the pressures on employers by allowing individuals to accumulate funds for future health care needs. I've also noted that the President has proposed permanently extending Archer Medical Savings Accounts. While other reforms are needed in the program to

encourage all insurers to offer the product, removing the time limitation on Archer MSAs is a positive step. I am hopeful that removing the uncertainty of the previous law, that limited Archer MSAs to five years and thus, discouraged insurers from getting into the market, will now pass and millions of Americans will look at this as a viable option for obtaining health insurance.

In that vein, I believe that we must also allow individuals to deduct all of their medical expenses not covered by private insurance or a government program. Prior to 1986, there was no limitation on such deductions. However, the '86 tax bill created a scheme whereby only expenses that exceed 7.5% of adjusted gross income are deductible. I plan to introduce legislation that will zero out the AGI limitation, and help millions of Americans who get no tax benefit for their out-of-pocket health care costs.

I was also happy to see that the President's budget will help more children get a quality education by improving on the No Child Left Behind Act. It does so by providing for a refundable credit of 50 percent of the first \$5,000 of qualifying education expenses for parents who move their kids to schools where they can get a better education. While my enthusiasm is tempered slightly by the fact that the definition of "qualifying student" is restricted to one who is enrolled in a failing school, this provision takes a substantial step towards giving parents the ability to decide where their children will be best educated, a goal which I wholeheartedly support.

In short, this is a good, sound budget. It provides for our priorities of winning the war on terrorism, Homeland defense and stimulating the economy and creating jobs. I commend President Bush, Secretary O'Neill and the entire Administration for their efforts and look forward to working with them in the coming months to get this budget signed into law.

Chairman THOMAS. Thank you.

Mr. Secretary, you are the Secretary of the Treasury. We are going to have the Secretary of Health and Human Services and the Director of the Office of Management and the Budget. I would simply request, perhaps in vain, that Members attempt to focus on the issues that are predominantly under the jurisdiction of the Department of the Treasury. We will have ample opportunity to direct other questions to the appropriate departments or agencies. With that, Mr. —

Mr. KLECZKA. Will the Chairman yield for a question on that?

Mr. Chairman, is not the Secretary of the Treasury a trustee on either Social Security or Medicare?

Chairman THOMAS. Yes. I will tell the gentleman that, as I indicated, it was a request by the Chair. And, clearly, being a trustee of those funds opens him up to a number of questions.

Mr. KLECZKA. I just wanted to clarify that. I know it is germane to his position in this government.

Chairman THOMAS. I would tell the gentleman if we were to examine Medicare, as we probably are going to in great detail tomorrow morning, and we would venture into questions suggesting that the President's 6.5 interest in Medicare+Choice, while not directed toward metropolitan statistical areas the way we would like, isn't a good policy, that kind of a question probably is not most appropriately directed to a trustee of the fund but to the principal administrator of the program itself. That was the thrust of the Chair's request.

Mr. KLECZKA. But the general health of the various trust funds would be somewhat germane.

Chairman THOMAS. Absolutely.

Mr. KLECZKA. Thank you very much.

Chairman THOMAS. With that, Mr. Secretary.

**STATEMENT OF THE HON. PAUL O'NEILL, SECRETARY, U.S.
DEPARTMENT OF THE TREASURY**

Mr. O'NEILL. Thank you, Chairman Thomas.

Chairman THOMAS. You might want to check your mike. They are very unidirectional.

Mr. O'NEILL. Do we have sound now?

Chairman THOMAS. There we go.

Mr. O'NEILL. We have sound.

Thank you Chairman Thomas, Congressman Rangel, Members of the Committee. Mr. Chairman, with your permission I have a short statement I would like to read, if it is OK with you.

Chairman THOMAS. Without objection.

Mr. O'NEILL. I can do it quickly.

Thank you for inviting me to testify today. We have had a year to work together, and you know I am an optimist about the future of the U.S. economy. I believe our economy has potential to grow substantially; in fact, to lead the world in the rate of productivity improvement as we have been for a very long time.

Even after a difficult year, my optimism about the fundamentals of the U.S. economy has not changed. I believe the data show we were on the verge of recovery before the September 11th terrorist attacks and that our resilience and determination have brought us back to the early stages of recovery today. We see more and more signs every day indicating that the seeds for recovery are there and only need nourishing to speed the process of putting Americans back to work. I believe we will return to prosperous economic growth rates of 3 to 3.5 percent as soon as the fourth quarter of this year, especially if we are able to pass still-needed economic security legislation to hasten and strengthen our recovery.

Strengthening our economy is a key goal of the President's budget. A return to our normal growth rates means jobs for the 1.4 million persons who have lost jobs during this slowdown.

Just as the strengthening economy means greater prosperity for our Nation's people, it also means greater strength for our government. It means greater revenues going into the Treasury, without raising taxes, giving us resources to address the Nation's needs and the retirement of even more Federal debt—leading to long-term economic security for our children. Even with all that must be done to enhance our security, we expect that a return to economic growth will bring us back to government surplus in 2005.

The economy's slowdown began in mid-2000, when GDP and job growth slowed sharply. Business capital spending began to plummet in late 2000 and accelerated its decline in 2001, dragging down the economy. In August we were beginning to see the evidence of an economic rebound. I firmly believe that, had it not been for the terrorist attacks of September 11th, that we would have seen an end to the economic downturn and would have avoided a recession.

The September 11th attack created shock waves that rippled throughout all sectors of the economy. Financial markets were shut down for almost a week, air transportation came to a standstill, and, as a result, GDP fell 1.3 percent at an annual rate in the third quarter.

By late November, the National Bureau of Economic Research declared the United States was in a recession. They designated the

end of the previous expansion for March, 2001, but they observed, as I have said, that the slowdown might not have met their qualitative standard for recession without the sharp declines in activity that followed the terrorist attacks.

In sum, the scorecard for the economy in 2001 reflected a combination of adverse events: The private sector lost more than 1.5 million jobs, the unemployment rate rose 1.8 percentage points, industrial production was off nearly 6 percent during the year, and industry was using less than 75 percent of its capacity at the end of the year.

As bad as these numbers are, they could have been worse. The well-timed bipartisan tax relief package put \$36 billion directly into consumers' hands in the late summer and early fall, providing much-needed support as the economy sagged. It was the right thing to do, at just the right time.

It is not surprising, then, that both the Congressional Budget Office and the Office of Management and Budget project deficits for this year and next as a result of the economic slowdown and the response to the September 11th attacks.

The President has presented a budget to speed our recovery.

First, the budget includes tax relief to stimulate job creation. The President's proposals—accelerated depreciation, speeding up the reduction in the 27 percent income tax rate, addressing the corporate AMT or alternative minimum tax, and checks to those who didn't benefit from last summer's tax rebates—enjoy bipartisan support in both Houses of Congress. I am eager to work with all of you to complete work on a package to create jobs and assist dislocated workers with extended unemployment insurance (UI) benefits and temporary assistance for health care.

Second, the President's budget proposes strict fiscal discipline, increasing spending for national security and homeland defense and holding the line on other spending. His management agenda calls for performance measures to be used to determine where budget increases are allocated so that our resources go into the projects and programs that make the biggest difference in people's lives. As the experience of the 1990s shows, this discipline is crucial to ensuring that we do not return to systemic deficits of the past. But fiscal discipline alone will not guarantee budget surpluses. We must return 3 to 3.5 percent annual growth to ensure surpluses for years to come.

The focus must be on restoring growth. Surpluses will then follow naturally. Raising taxes would stifle the process of getting Americans back to work. Raising taxes is a bad idea as our recovery is struggling to take hold. According to 1999 data, the most recent available, 33 million small business owners and entrepreneurs pay taxes under the individual income tax rates. They have made business plans that assume that the tax relief enacted last summer will take place as scheduled. Eighty percent of the benefit of cutting the top two rates goes to small business owners and entrepreneurs. These are the engines of job creation in our economy.

We believe tax relief should be accelerated as the President has proposed to boost job creation. Such relief will have minimal or no effect on long-term interest rates. According to a recent analysis by the Council of Economic Advisors, an expected \$1 trillion change in

the public debt over 10 years would tend to raise the long-term interest rates by 14 basis points. Since the tax cut last year, the 10 year nominal rate has averaged 4.93 percent, which is substantially below the 6.16 percent averaged from 1993 to the year 2000.

Restoring growth is the key to America's future. Restoring growth will ensure we have the resources in Washington to fight the war on terrorism, to provide for homeland defense and provide the services the American people expect and demand. The President's budget will help to ensure that both peace and prosperity are restored to the American people as soon as possible.

That is my statement, Mr. Chairman.

[The prepared statement of Secretary O'Neill follows:]

Statement of the Hon. Paul O'Neill, Secretary, U.S. Department of the Treasury

Good morning Chairman Thomas, Congressman Rangel and members of the committee. Thank you for inviting me to testify today. Now that we've had a year to work together, you should know that I am an optimist about the US economy. I believe we always have untapped potential that can be unleashed to spread prosperity throughout the nation. Never has that been more true than right now. Even after a difficult year, my optimism about the fundamentals of the US economy has not changed. I believe we were on the verge of recovery before the September 11 terrorist attacks, and that our resilience and determination have brought us back to the early stages of recovery today. We see more and more signs every day indicating that the seeds for a recovery are there, and only need nourishing to speed the process of putting Americans back to work. I believe we will return to prosperous economic growth rates of 3 to 3.5 percent, as soon as the fourth quarter of this year, especially if we are able to pass still-needed economic security legislation to hasten and strengthen our recovery.

Strengthening our economy must be our primary goal. It is the focus of the President's budget. That must be our goal, because a return to our normal growth rates means jobs for the 1.4 million Americans who have lost jobs during this recession. Just as a strengthening economy means greater prosperity for our nation's people, it also means greater strength for our government. It means greater revenues going into the Treasury, without raising taxes, giving us resources to address the nation's needs, and the retirement of even more federal debt—leading to long-term economic security for our children. Even with all that must be done to enhance our security, we expect that a return to economic growth will bring us back to government surplus in 2005.

The economy's slowdown began in mid-2000, when GDP and job-growth slowed sharply. Business capital spending began to plummet in late 2000, and accelerated its decline in 2001, dragging down the economy. In August we were beginning to see the evidence of an economic rebound. I firmly believe that had it not been for the terrorist attacks of September 11th, that we would have seen an end to the economic downturn and would perhaps have avoided a recession. The September 11 attacks created shockwaves that rippled throughout all sectors of the economy. Financial markets were shut down for almost a week. Air transportation came to a standstill. As a result, GDP fell 1.3 percent at an annual rate in the third quarter.

By late November, the National Bureau of Economic Research declared that the US was in a recession. They designated the end of the previous expansion to be March 2001, but they observed that the slowdown might not have met their qualitative standards for recession without the sharp declines in activity that followed the terrorist attacks.

In sum, the scorecard for the economy in 2001 reflected a combination of adverse events:

- The private sector lost more than 1.5 million jobs.
- The unemployment rate rose 1.8 percentage points.
- Industrial production was off nearly 6 percent during the year.
- Industry was using less than 75 percent of its capacity.

As bad as these numbers are, they could have been worse. Our well-timed bipartisan tax relief package put \$36 billion directly into consumers' hands in the late summer and early fall, providing much needed support as the economy sagged. It was the right thing to do, at just the right time.

It's not surprising then that both the Congressional Budget Office and the Office of Management and Budget project deficits for this year and next as a result of the economic slowdown and the response to the September 11 attacks. Last April's budget forecast a fiscal 2002 surplus of \$283 billion. The Mid-Session review figures, released in August, took account of the impact of the President's tax relief package and projected a \$195 billion surplus in fiscal 2002. The new budget forecasts a fiscal 2002 deficit of \$9 billion, assuming no policy action to stimulate the economy. The reduced surplus estimates are the result of the economic downturn and the response to the September 11 attacks. CBO's projections confirm that tax relief played a minor role in the surplus decline in the next few years—accounting for less than 12 percent of the decline in 2002 and less than 28 percent in 2003.

	FY02 surplus (in billions)
April 2002 budget baseline:	\$283
Changes from:	
weaker economy/technical changes	– 197
enacted spending	– 54
tax relief	– 40
February 2003 budget baseline:	– 9

The CBO budget projects a 10-year surplus of \$1.6 trillion. Last August, after factoring in the tax relief package, the CBO projected a \$3.4 trillion surplus for the next 10 years. The recession and the war on terrorism depleted the 10-year projections by \$1.8 trillion. The lesson from these numbers is simple—10-year projections are a useful discipline but they do not predict the future. None of last year's 10-year estimates foresaw the events of September 11 or a negative \$660 billion worth of "technical changes" that are now included in the new 10-year estimates by agreement among the technical experts. We do know about the here and now, and we should deal with the here and now, reigniting growth to restore long-term surpluses.

The Administration's growth projections are similar to the consensus of private forecasts. Over 90 percent of the Blue Chip Economic Indicators panel members say the recession will end before April of this year. We share that assessment. Personally, I am optimistic that the economy will do even better than our budget assumptions suggest. For the near term, we expect the economy to grow 2.7 percent during the four quarters of 2002. That projection includes the foreseeable effects on the economy of the President's economic security package.

The lesson is clear. A strong economy is crucial to restoring budget surpluses. Some would suggest that we need surpluses to improve our economy. They have the logic backwards. Growth creates surpluses, not the other way around.

The federal budget was in deficit every year from 1970 through 1998. From 1970 through the early 1990s, government spending growth exceeded government revenue growth by $\frac{3}{4}$ of a percentage point a year, on average. Fiscal discipline was imposed by the historic *Omnibus Budget Reconciliation Act*, signed in 1990 by President Bush. With fiscal restraint made an integral part of the budget process, once the economy took off in the 1990s, revenue growth was double the pace of spending growth. It was the rapid economic growth of the 1990s that generated the burgeoning budget surpluses, which appeared even as federal outlays grew about 3.5 percent a year from 1993 through 2000.

Today the economy is recovering. The tax cut of last May helped to keep the economic downturn shallow and it will continue to help. Energy prices have retreated. The Federal Reserve has reduced short-term interest rates 11 times since the beginning of 2001. Measures of consumer confidence are bouncing back. The index of leading indicators increased sharply in December for the third straight gain. Motor vehicle sales have remained strong. And initial filings for unemployment benefits are in decline. But we all know that unemployment itself is a lagging indicator. Although the current trend is positive, too many people will remain out of work. And given the choice, they'd rather have a regular paycheck than an unemployment check.

The President has presented a budget to speed our recovery. First, the budget includes tax relief to stimulate job creation as a crucial tool to speed our recovery and put Americans back to work. The President's proposals—accelerated depreciation, speeding up the reduction in the 27 percent income tax rate, adjustments to the corporate AMT so it doesn't cancel out tax relief, and checks to those who didn't benefit from last summer's tax rebates—enjoy bipartisan support in both houses of Congress. I'm eager to work with all of you to complete work on a package to create

jobs and assist dislocated workers with extended unemployment benefits and temporary assistance with health care.

Second, the President's budget proposes strict fiscal discipline—increasing spending for national security and homeland defense, and holding the line on other spending. His management agenda calls for performance measures to be used to determine where budget increases are allocated—so that our resources go into the projects and programs that make the biggest difference in people's lives. As the experience of the 1990s shows, this discipline is crucial to ensuring we do not return to systemic deficits of the past. But fiscal discipline alone will not guarantee budget surpluses. We must return to 3 to 3.5 percent annual growth to ensure surpluses for years to come.

The focus must be on restoring growth. Surpluses will then follow naturally. Raising taxes would stifle the process of getting Americans back to work. This is a bad idea, as our recovery is struggling to take hold. According to 1999 data, the most recent available, 17 million small business owners and entrepreneurs pay taxes under the individual income tax rates. They have made business plans that assume that the tax relief enacted last summer will take place as scheduled. Eighty percent of the benefit of cutting the top two rates goes to small business owners and entrepreneurs. These are the engines of job creation in our economy.

Tax relief should be accelerated, as the President has proposed to boost job creation. Such relief will have minimal, or no, effect on long-term interest rates. According to a recent analysis by the CEA, an expected \$1 trillion change in the public debt over 10 years would tend to raise the long-term interest rate by 14 basis points. Since the tax cut last year, the 10-year nominal rate has averaged 4.93 percent, which is substantially below the 6.16 percent averaged from 1993 through 2000.

Restoring growth is the key to America's future. Restoring growth is the key to ensuring we have the resources in Washington to fight the war on terrorism, provide for homeland defense and provide the services the American people demand. The President's budget will help to ensure that both peace and prosperity are restored to the American people as soon as possible.

Chairman THOMAS. Thank you very much, Mr. Secretary.

I do understand that the President and you believe that a stimulus package is still desirable. The question is whether or not the makeup of that package would be roughly the same as it was when the House first acted in October and then followed up in December with the second package that was passed.

One of the differences between the first and the second package was an attempt by the House to collect the concerns on the unemployed, both in terms of the unemployed benefits and the health insurance protection that we knew would probably occur if events had transpired the way they normally do. The House passes a bill, the Senate passes a bill, we go to conference, and we make those kinds of adjustments. So the December bill was I think an attempt on the part of the House to say, had we gone to conference, this is what we think the bill would have looked like in an attempt to provide the Senate with a structure that they could pass relatively quickly. As we know, that didn't occur. We are now into February.

I still believe that the assistance for the unemployed portion of the package probably, if anything, is more underscored as we move to the date when they begin to run out of the usual 26-week benefits.

I don't think also there is much additional concern about maintaining consumer demand. Some of us were pleasantly surprised and some economists were wrong that when the auto program of 0 interest financing ended in October most people believed that they would eat significantly into auto sales for December and Janu-

ary. It appears there was only about a 5 percent drop. It wasn't nearly as much as most people thought it would be.

In addition, the individual tax rates, especially at the middle income level, 27 to 25, given who pay that level of taxes, could certainly be a bit of consumer demand as well.

But what I have been concerned about is the whole business segment of the package. More and more, the argument that probably was largely unnecessary, and now it is completely unnecessary, when the whole question of inventories, liquidating inventories and then the need to rebuild was one of the keys to economic recovery. To me, dealing with expensing, especially on short-term depreciation, is very much the same as consumer demand, if we could get some purchases done in the short term.

Alan Greenspan in front of the Senate said that there were some negative aspects to a short-term expensing. I think we understand them. My concern is that does the Administration, does the Treasury, do you have a concern about the way in which the depreciation package would be structured?

The Senate seems adamant that they don't want any kind of depreciation structure for more than 12 months. They define that as short term. I understand "permanent." That means really long term. But I don't know that 12 months is a significant or important or really appropriate definition for short term; and I believe that some of the debate is going to hinge on the way in which we view 12 months, 24 months, 36 months, probably 48 months on the outside in an area that we think could have a relatively immediate and stimulative effect on the economy, even today.

Comments on the structure of the expensing on depreciation, length of it, amount, where and how it would stimulate the economy.

Mr. O'NEILL. Thank you, Mr. Chairman; and thank you for the review of the process.

As we in the Administration have been engaged with you and with your counterparts on the other side of the Hill, we have been greatly appreciative of the work that has been done in this Committee under the Chairman's leadership in both in the October work and subsequently in the December work in order to provide a basis for what we believed was going to be a basis for action in the Senate so that we could have finished this stimulus work before the Congress went home for the Christmas recess.

We continue to believe that what you did in the Committee and included in the bill that you sent over to the Senate in December is the right basis for dealing with accelerated depreciation, and we are hopeful that the Senate will see the wisdom of what you have done and will quickly deal with this issue so that we can get it behind us and we can assure what we believe are the consequences of this action, which is to add momentum and speed to the economic recovery that we all want.

I don't know anyone who would like to go slower or would like to end up at a lower level than 3 or 3.5 percent. The President continues to believe the stimulus proposal that you passed in December is the right direction to go and that we should do it now.

Chairman THOMAS. Thank you very much, Mr. Secretary. The gentleman from New York wish to inquire?

Mr. RANGEL. Thank you. Yes.

Mr. Secretary, we are flattered when you talk about the good work of this Committee and the leadership of our Chair, but you should know that it is really not the Committee, it is the Chair and the majority.

First of all, what this stimulus package—I have had more discussions with you on this subject and Treasury Department than I have been able to have with the Chairman on this subject of the stimulus package. And so—the Members, the Democratic Members have even less than I. So that if you want to compliment the Chair for the way that he has handled this, that is okay with me.

The second thing is that the Committee should get no credit for the second stimulus package, but you should give that credit to the Rules Committee. Because that bill never came before the Ways and Means Committee. It went to the Leadership, the Rules Committee and came to the floor. But we will accept the compliments.

But you should know that the President's efforts to be bipartisan stops when he gets to the doors of this Committee. That is tragic, and it is unfortunate, and this is especially so during a time of war. But, as I have indicated, I am so pleased that war appears to have brought us together for at least the hearing of the 26th, and let's have a good beginning on that.

I am sorry that the Chair didn't give me a list of the questions that he would suggest that I ask you, but, at the risk of going off on the Social Security thing, it is just hard for us to understand how it is, at a time where all of us, whether Democrats or Republicans or the Administration, was concerned about Social Security, that we find ourselves because of the recession, because of war, because of homeland security, that the funds that are coming in right now are basically funds that are supposed to be earmarked—not lockboxed but earmarked for Social Security Medicare.

We can understand how during a time of war that we do the best we can with what we have to work with, but if indeed the President is now protecting and asking the American people and the Congress to consider making the tax cuts that have been put into place permanent and if you know as a trustee that we expect to have a real 40 million people to become eligible for Social Security and Medicare benefits, it just defies sound fiscal policy that we should be talking about tax cuts at a time that we are having deficits and at a time where the Social Security fund is not secure and at a time where the processes of reform don't appear to be on the near horizon.

So we just hope, as the Secretary of Health and Human Services, as the Secretary of Defense and other people come to support their particular responsibilities, that we could hear the same strength in your voice and testimony in terms of protecting the Social Security trust fund. Because war is supposed to be a time of sacrifice, and it seems as though one of the major contributions that the Administration is proud of is that those that make the most will be getting the largest tax cuts, and that will be their contribution to the war effort, while those who are depending on the Federal Government for a lot of services, that is where fiscal responsibility comes, because that is where we all have to make sacrifices.

So I, for one, am very concerned that—my concern about people getting from government what they are entitled not be confused with a lack of patriotism. If it is going to be that we don't have money to do these things because of sound fiscal policy, why do we say up front that we want tax cuts before we can see how we can balance the budget and do these things? Maybe the tax cuts should be even deeper than projected. But to do it beyond 5 years, beyond 10 years, based on speculation seems to be—not to be sound fiscal policy.

I look forward to your response on that, Mr. Secretary.

Mr. O'NEILL. Thank you.

First, let me say—and certainly you know this as well—that every dollar that the government collects for Social Security and Medicaid is credited to the trust fund. No person out there who is watching this on television should have any concern that the Social Security funds are not being credited to the trust fund. Every dollar of Social Security money that is collected goes into the trust fund.

The question that you raised or the comment you raised about the tax system is an interesting one. I have had a chart prepared that I think bears some examination. This is a chart that shows what the expectation is for revenue growth by the Federal Government over the years between fiscal year 2001 and 2011. What this chart shows is that, with the tax system that is in place as agreed, voted by the Congress, I think with lots of shared—a sense of accomplishment last June, the revenue taken in by the Federal Government over this 10-year period is going to increase by 55 percent.

So, contrary to some impressions that are left, that somehow Federal revenues are going down, this is the fact. With the tax law as it is enacted, with the perspective of further rate reductions and other provisions, the U.S. Federal tax revenue will increase by 55 percent over this time period.

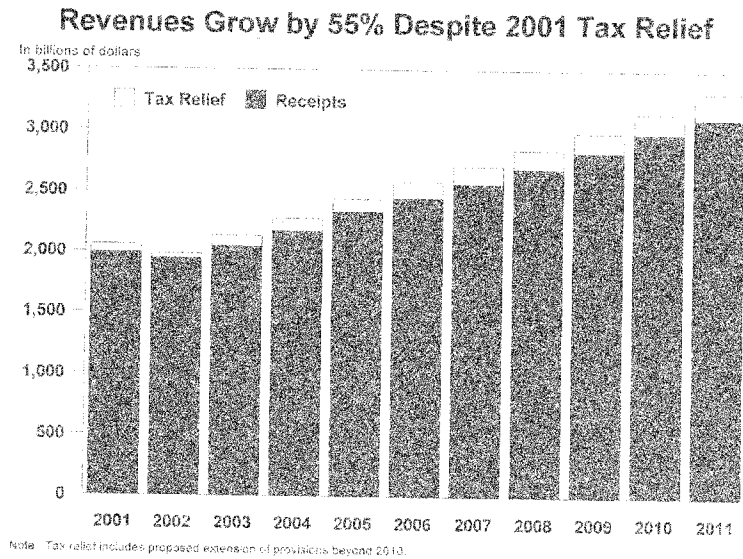
The little yellow parts of these bars, which you may have trouble seeing from a distance—

Mr. McDERMOTT. Could we, as Members of the Committee, have a copy of that? We can't see very well. Some of us have elderly eyes, and it would be nice if you would bring some copies for all of us.

Mr. O'NEILL. We do have some copies.

Mr. McDERMOTT. We know the people at home can see it on the television, but we can't see it.

[The chart follows:]



Mr. O'NEILL. The yellow parts of these bars illustrate the amount of revenue reduction from what would otherwise be associated with the agreed tax cuts of last year, and I think the data makes the point very well.

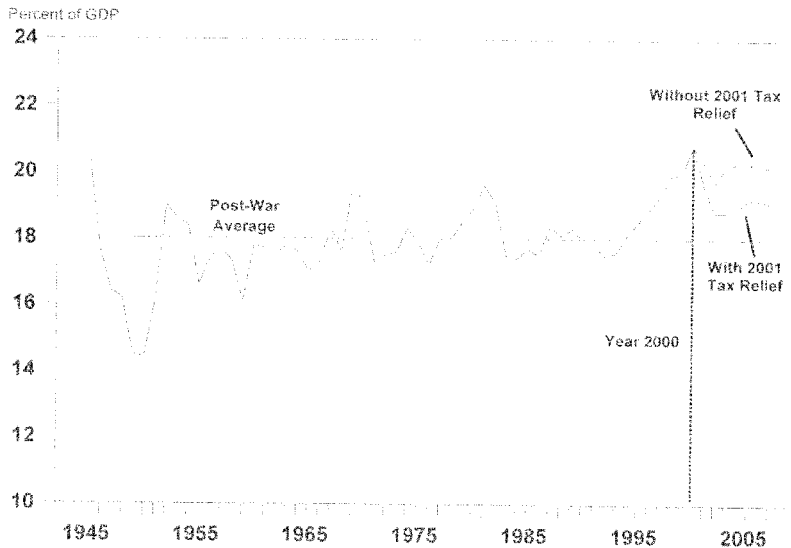
Now related to this set of facts is this fact: That even with the tax enactment of last year, your Federal Government, our Federal Government, is going to be collecting about 19 percent of the GDP in Federal taxes, which will leave us above the trend line growth rate that has existed for a very long time.

I didn't bring the detailed chart, but I will make that available for the record so that you can see the agreed tax policy effect on the Federal Government's share of the GDP. This is the chart. As I say, I will make it available so the whole Committee has in your own hands this data—set of facts about what it is we are proposing to do in terms of raising money from the people.

Mr. RANGEL. Thank you.

[The chart follows:]

Tax Take Remains Historically High



Chairman THOMAS. The Chair would ask unanimous consent that a series of questions submitted by Mr. Shaw be placed in the record. Without objection.

The gentleman from Illinois wish to inquire?

[Questions submitted from Mr. Shaw to Secretary O'Neill, and his responses follow:]

Question 1: Does the administration's proposal to expand IRS's direct assistance to taxpayers filing online (EZ File) potentially create a conflict with private accountants and tax return preparers, running counter to OMB's Circular A-76?

Response: The Administration's proposal to give taxpayers the option to file their tax return online without charge is based on two principles: no one should be forced to pay extra just to file his or her tax return, and the IRS should not get into the software business.

First, the ability to file electronically is an important benefit for all taxpayers because it is simple, is less prone to errors, and results in quicker refunds. Electronic returns also save the Government time and money. In the 1998 IRS Restructuring and Reform Act, Congress recognized the value of electronic returns and established a goal of having at least 80 percent of all returns filed electronically by 2007. The Administration's proposal will greatly enhance the IRS' ability to meet this goal.

Second, however, Treasury does not intend for the IRS to get into the software business. Taxpayers have, and will retain, the ability to seek professional or other assistance in preparing a tax return. Treasury believes that the best way to accomplish this is by forging a new partnership with existing private sector expertise. Treasury and IRS officials, along with members of the IRS Oversight Board and the Electronic Tax Administration Advisory Committee, have begun a dialog with representatives of the tax preparer industry to explore ways to provide taxpayers with the option to e-file.

Question 2: What potential privacy issues has Treasury identified and how are you prepared to deal with them?

Response: Treasury believes that the facilitation of electronic filing will enhance taxpayer privacy. Some taxpayers do not file electronically now because they don't want to send their personal tax information to the IRS via a third party. There should be ways to address this concern. For example, in the case of self-preparers, the availability of direct electronic filing would eliminate the need for taxpayers who have this concern to share their sensitive financial information with a third party.

The IRS is currently in a dialog with industry to find ways to expand e-filing opportunities and explore solutions. It should be noted that the IRS's continuing partnership with the private sector on e-file initiatives requires a strict adherence to the privacy rules applicable to tax return preparers in section 7216 of the Internal Revenue Code.

Question 3: What internal agency conflicts potentially could arise by having IRS assuming roles as both tax return preparer and its existing role for developing regulations, collecting, and auditing tax returns?

Response: The Administration's e-filing proposal simply stated is "to provide taxpayers with the option to file their tax return on-line without charge". Treasury believes the best way to accomplish this is by forging a partnership with existing private sector expertise in the field. Taxpayers have the ability to seek professional or other assistance in preparing a tax return.

This proposal should not create any conflicts with, and is consistent with, the IRS' traditional regulatory and enforcement roles. IRS already provides an automated tax return option via telephone, called Tele-file, for Form 1040EZ filers. In addition, the IRS has provided taxpayers with guidance and assistance for many years. IRS forms, instructions, and publications, for instance, are already available to taxpayers for free, and include comprehensive guides on various tax issues as well as taxpayer duties and obligations. The IRS has held a number of Taxpayer Assistance Days throughout the country that allow taxpayers to discuss problems or issues directly with an IRS representative. The IRS sponsors the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, which provide free tax preparation assistance. The IRS also provides automated and live assistance through toll-free numbers, as well as information through its web site. All of these efforts are an important part of the IRS' mission to explain, and guide taxpayers through, compliance with the tax laws.

Mr. CRANE. Thank you, Mr. Chairman.

Mr. Secretary, I have been a long-time supporter and active proponent of medical savings accounts (MSA) and am pleased to see a permanent extension of Archer MSAs in the President's budget. The 5-year revenue loss for Archer MSAs is nearly \$2 billion. However, we know in the real world that the tax changes we make, whether they be MSAs or reducing marginal tax rates or increasing incentives for savings, have an effect on people's economic behavior; and you provided a fine explanation whereby this behavior translates into reduced health care costs. Yet in the revenue estimates we typically only pay lip service to this behavior, and in many cases we completely ignore it.

For example, since MSAs reduce health costs, then to the extent that the government pays for health care in the form of Medicaid or other programs the score should go down by some amount.

It is my understanding that you have the authority to issue a Treasury directive that could make the revenue estimating process more transparent or impose dynamic scoring, the result being potential revenue savings for proposals like Archer MSAs. I would like to know what steps, if any, you are contemplating in regard to this matter, and I would like to offer my assistance in working with you.

Mr. O'NEILL. Thank you very much, Congressman Crane.

Since I have been at Treasury, we have been working hard on this the subject of estimation and looking at ways that we can bring to the Congress and to the American people not just the static estimates of the past but, as you characterize it, dynamic estimates so that everyone will have an opportunity to see the difference and as we go through time we can see which estimates turn out to be more correct through this process.

My own view is that we should not have one system or the other, but we should have both. We should explain the assumptions that are incorporated in these alternative analytic schemes, and we would all benefit from learning which models better represent the reality as we collect experience.

Mr. CRANE. Thank you, Mr. Secretary.

Chairman THOMAS. The gentleman from California, Mr. Stark, wish to inquire?

Mr. STARK. Thank you, Mr. Chairman.

Mr. Secretary, the President's inadequate budget is a product and consequence of your failed economic policy. A year ago, we had a record surplus of \$5.6 trillion; and with those resources we could have strengthened Social Security, secured a prescription drug benefit that was worth anything, and simultaneously provided homeland security and defense. Instead, the President and his Administration pushed through a tax cut that squanders our prosperity on those who least need it.

Now, appallingly, the President has called to make these tax cuts permanent. Apparently, the rich aren't rich enough, particularly Enron and his friends there. In the meanwhile, the seniors who cannot afford prescription drugs, parents who cannot afford child care, families who do not have health care, and poor people in need of housing are left out in the cold and out of the President's plan.

The President should be ashamed. This budget neither represents sound economic policy nor the moral values the President so fervently espouses. This budget underfunds critical programs that Americans count on in their everyday lives. Efforts to strengthen Social Security, provide a prescription drug benefit, protect our environment, expand health care coverage to the uninsured get rhetorical mention in the budget but absolutely no significant funding.

Now, the President is right to devote resources to improving security and national defense around the world, but his naive devotion to tax cuts helps him dismantle Social Security and Medicare, his avowed intention.

This budget is disappointing on a grand scale, and we will suffer the consequences for years to come. The President announced during his State of the Union speech that he wants to make these tax cuts permanent. CBO just reported that making the tax cut permanent would decrease revenues by \$569 billion and result in a debt service payments increase of \$58 billion, for a total cost of more—\$627 billion more than exists in the entire Medicare trust fund which you will spend and deplete if you follow this budget.

This amount of money also—which \$600 billion would enable us to provide a Medicare prescription drug benefit to all beneficiaries, not just some cockamamie discount card.

Why, why did the President give wealthy individuals in this country absolute priority over Medicare beneficiaries?

Mr. O'NEILL. If I may, Congressman Stark, go back to the foundation of your comments. What the CBO—for those out there in the televisionland, what the Congressional Budget Office projections show is that for the year 2002, as we have moved forward from a year ago when the agreed budget projection was for a surplus of \$313 billion, the following facts have contributed to the CBO's January projection of negative \$21 billion: The tax law effect on the \$313 billion: \$38 billion; defense appropriations: \$33 billion; nondefense appropriations debt service and other cost: \$20 billion. So the January, 2001, projection of \$313 billion surplus was reduced by \$91 billion by those events. \$38 billion again for the tax law change, and the rest for defense and nondefense appropriations.

The rest of the change in the surplus estimate was a consequence of \$148 worth of economic effect because of the slowness in the economy, and I would observe that both the Administration and the independent Congressional Budget Office numbers were basically the same. And a further \$94 billion was a consequence of so-called technical changes. So the tax law had an effect of 15 percent at most in the change on the budget protection.

Mr. STARK. But what about for the 10 years?

Mr. O'NEILL. For the 10 years it is interesting to observe that, according to the CBO, of the \$5.6 trillion estimate that existed in January of 2001, \$1 trillion, \$275 billion is related to the tax law change. And I find it really very interesting and telling that—

Mr. STARK. I might just notice the red, Mr. Secretary—

Mr. O'NEILL. Six hundred sixty—

Mr. STARK. Reduction because of the tax cut and the blue is the reduction because of defense and the other blue is nondefense. So about 70 percent of the reduced budget surplus is over 10 years come from the June tax cut. So if you want to show us your rosy scenario here of 10 years, let's look at the results of the tax cut over 10 years so we are comparing an apple and an apple, okay?

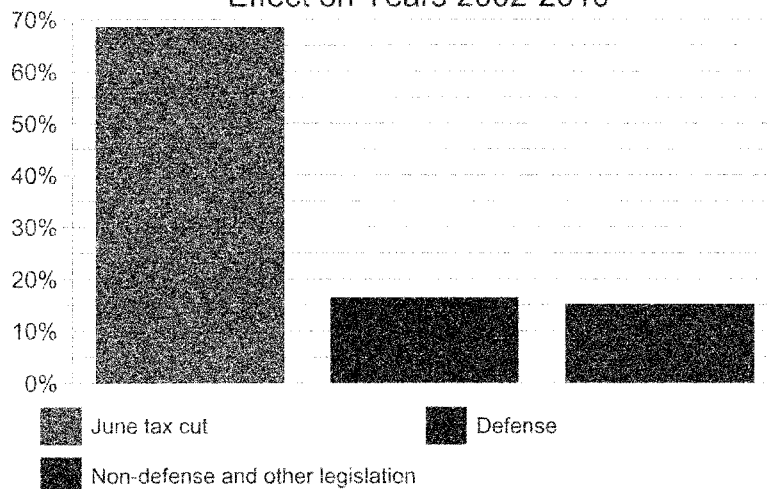
Mr. O'NEILL. I'm sorry, Congressman, I don't understand your concept. If you are looking at what happened—

Chairman THOMAS. Excuse me. The Chair would be interested in seeing the chart. I cannot read the bottom of it. Could I see the chart for just a second, Mr. Stark? I appreciate it.

Mr. Secretary, these are assumptions prepared by the Committee on Ways and Means' Democratic staff.

[The chart follows:]

What Reduced the Budget Surpluses Contributions by Different Legislation Effect on Years 2002-2010



Accounts for \$2.1 trillion change in CBO budget surplus projections from Jan. '01 to Jan. '02. Ways & Means Comm. Dem Staff. 2/03/02

Mr. O'NEILL. I have not seen these numbers before. This is certainly—I would say to you that this is not a correct—what you have here is not even close to a correct characterization, according to the independent Congressional Budget Office.

Mr. STARK. It is their numbers, Mr. Secretary.

Mr. O'NEILL. May I give you this table from the Congressional Budget Office? It shows, if I may use the numbers with you of the \$5.6 trillion, that the change in the tax law that was enacted last June and acclaimed by Members on both sides, reduced that surplus estimate by \$1,275,000,000. Others changes include \$300 billion for defense.

I do not hear anyone say we should not do defense spending. There is \$249 billion for nondefense appropriations, and the debt service is 595, an unavoidable cost of a slower economy.

Importantly, economic changes and technical changes account for \$1.589 trillion because of economic changes. And I call attention to the fact because I think this is quite important in looking at these 10-year numbers, there is \$660 billion worth of change in the surplus estimates related to so-called technical adjustments by the estimators.

[The table follows:]

Summary Table 1.—Changes in CBO's Baseline Projections of the Surplus Since January 2001
(In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002– 2006	Total, 2002– 2011
Total Surplus as Projected in January 2001	313	359	397	433	505	573	635	710	796	889	2,007	5,610
Changes												
Legislative												
Tax act ^a	– 38	– 91	– 108	– 107	– 135	– 152	– 160	– 168	– 187	– 130	– 479	– 1,275
Discretionary spending	– 44	– 49	– 52	– 54	– 56	– 57	– 58	– 59	– 60	– 61	– 255	– 550
Other	– 4	– 6	– 5	– 3	– 4	– 2	– 2	– 2	– 2	– 2	– 23	– 33
Debt service ^b	– 5	– 12	– 22	– 32	– 44	– 57	– 72	– 88	– 106	– 124	– 114	– 562
Subtotal	– 91	– 158	– 186	– 197	– 238	– 268	– 293	– 317	– 355	– 317	– 870	– 2,420
Economic	– 148	– 131	– 95	– 81	– 75	– 75	– 76	– 79	– 82	– 88	– 530	– 929
Technical ^c	– 94	– 84	– 62	– 51	– 64	– 64	– 65	– 64	– 65	– 45	– 356	– 660
Total Changes	– 333	– 373	– 343	– 330	– 377	– 406	– 433	– 460	– 502	– 450	– 1,757	– 4,008
Total Surplus or Deficit (–) as Projected in January 2002	– 21	– 14	54	103	128	166	202	250	294	439	250	1,602
Memorandum:												
Changes in the Surplus by Type of Discretionary Spending												
Defense	– 33	– 29	– 29	– 29	– 29	– 29	– 30	– 30	– 31	– 32	– 149	– 301
Nondefense	– 11	– 20	– 23	– 25	– 26	– 28	– 28	– 29	– 29	– 30	– 106	– 249

SOURCE: Congressional Budget Office.

NOTE: For purposes of comparison, this table shows projections for 2002 through 2011 because that was the period covered by CBO's January 2001 baseline. The current projection period extends from 2003 through 2012.

^aThe Economic Growth and Tax Relief Reconciliation Act of 2001, which was estimated at the time of enactment to reduce revenues by \$1,186 billion and increase outlays by \$88 billion between 2002 and 2011.

^bReflects only the change in debt-service costs that results from legislative actions. Other effects on debt-service costs are included under economic and technical changes.

^cTechnical changes are revisions that are not attributable to new legislation or to changes in the components of CBO's economic forecast.

Mr. STARK. If you care to put that in, Mr. Secretary, then you get 40 percent, approximately, for the tax cut, 40 percent for the economic changes, and less than 10 percent due to the nondefense and defense.

Mr. O'NEILL. I stipulate that characterization. I don't think your chart shows that.

Mr. STARK. That is the same chart without the economic, and this is the same chart with it. But the program that you have put forth is reflected in that chart because you do not have anything to do with the economic changes.

Mr. O'NEILL. That does not look like 43 percent.

Chairman THOMAS. The gentleman's time has expired.

The Chair would indicate if any other Members have charts, we would like to duplicate them so that Members can see them. I had not anticipated a duelling chart hearing. But if Members could at least look at them.

The reason I made this statement earlier is that it is the fine print in the bottom in terms of who it is coming from and what the assumptions are associated with the very brightly colored and large columns that is oftentimes more important than the columns themselves.

Does the gentleman from New York wish to inquire?

Mr. HOUGHTON. Yes, thank you, Mr. Chairman.

Glad to have you here, Mr. Secretary. I have just one direct question. Maybe you would like to elaborate on it.

The Administration has indicated they are undertaking a project to achieve significant simplification of the Tax Code. Would you like to break that down a little bit?

Mr. O'NEILL. Thank you very much, Congressman. As I have had an opportunity to testify here before, I think we have a major challenge with our Tax Code because it is so enormously complicated. We have begun an effort to identify changes that we can work with the Committee and with other oversight bodies to do things that we can administratively, and to shape into perhaps objects of legislation changes that would be helpful to individual Americans as they try to respond to the complexity of our Tax Code.

I think one of these areas that is very difficult is one that Commissioner Rossotti has put in front of me, as I have challenged him, as to how we can simplify the Tax Code. That area is in the area of how we define "child" from the point of view of the Tax Code.

It turns out that we have many different definitions of what a "child" is, believe it or not, when it comes to the use of the Tax Code. Chairman Rossotti has said to me that he believes if he had to deal with the definition of "child" in the earned income tax credit, that he would be found wanting; which is to say, that he does not believe he could easily understand how to apply the definition of "child" as we have incorporated it in the Tax Code for this purpose.

So in this area and in many others, we are looking at ways that we can create a simplification and better compliance and reduced costs of administration, because with all of the good intentions that

I'm sure are reflected in the 10,000-plus pages of the Tax Code, we obviously have room for improvement.

We are working out a way to identify those things and to take administrative action where we can to work with you to bring some of these things through the legislative process, where that is required.

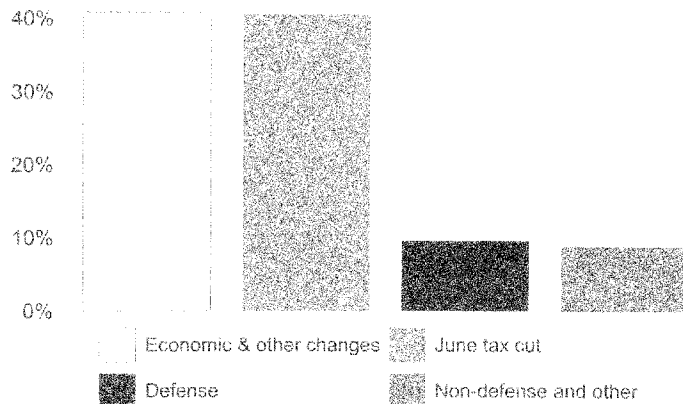
Chairman THOMAS. Does the gentleman from California, Mr. Matsui, wish to inquire?

Mr. MATSUI. Thank you, Mr. Chairman. Thank you very much, Mr. Secretary, for appearing before us. We appreciate it.

Mr. Stark showed you a chart that basically took into consideration legislative changes and not changes or reexamination and changes in the projections in the economy. The chart that I have up there at this particular time shows what happened to the surplus, the \$5.6 trillion surplus that we estimated January of the year 2001.

[The chart follows:]

What Reduced the Budget Surpluses By Percentage, 2002-2010



Accounts for \$3.6 trillion change in CBO budget surplus projections from Jan. '03 to Jan. '02. Ways & Means Committee Staff, 1/03/02

If we look at the yellow bar, it indicates basically a change in the economic projections. Essentially, 42 percent of the surplus was reduced because of the reexaminations. In fact, if one looks at this in terms of year by year, the yellow bar actually is high this year; it is about 70 percent because of the recession, and then it decreases over the next 9 years. But it is still a large number in the year 2010, mainly because the projections in 2001 were very, very optimistic and are less optimistic now.

The red line or red bar basically is the June tax cut accumulated over 10 years without making it permanent. That comprises 41 percent of the total, of the total surplus. Then you have defense, which includes the war effort, incidentally. The defense increases by the President and also the war effort are included, which is only 9 percent of the surplus, which is about \$560 billion, and the non-defense spending, which is increases in housing and those other expenditures, is about 8 percent.

So the war effort is basically a very small part of the reduction of the surplus. The large part of it in terms of what we can do as legislators and what the President can do as the Executive is basically the tax cut. The tax cut is 41 percent of the reduction in the surplus.

If I may, Mr. Secretary, you answered a question that Mr. Rangel asked, and said that the trust fund, all the money coming in in payroll taxes is credited to the trust fund; which is correct, it is credited to the trust fund. But you also said at some prior time that "it seems very unwise to think about using the Social Security Trust Fund moneys in some other way" besides putting it in Social Security "because at their current levels and with the current benefit structures, we are not accumulating enough money."

What is interesting, Mr. Secretary, is that the tax cut is \$1.3 trillion over 10 years. You take the loss of interest in that and it is about \$1.6 to about \$1.7 trillion.

In the President's revised budget, using essentially CBO numbers, in the President's revised budget the tax cut is the same, but in the baseline currently, the trust funds over the next 5 years, the Social Security Trust Fund, the range from other expenditures plus the tax credits is \$298 billion. That is under the current baseline.

Under the President's projection over the next 5 years, it goes up by \$606 billion to a total of \$904 billion. In other words, \$904 billion over the next 5 years will be used—instead of putting it into the Social Security Trust Fund for people's retirement, will be used for tax cuts and other expenditures. I think that number is undisputable.

In fact, over a 10-year period, the total amount raided from the Social Security Trust Fund, that is, individual's payroll taxes, is \$1.5 trillion, which is about the same amount, incidentally, as the tax cut over the next 10 years, if you do not make it permanent, just if you keep the tax cut temporary.

I guess what my concern is, Mr. Secretary, and I think the concern of a lot of people, and as the American public finds out more and more about this, I'm sure it will be a concern as well, is that because the tax cut equals the amount we are raiding the Social Security Trust Fund, it is almost exact, it is ironic, over the next 10 years. And because the tax cut—the top 1 percent, which is the average income of \$1.1 million on the average tax return—the top 1 percent gets 38 percent of that tax cut, and the elevator operator and the waitresses at the House dining room are paying for that tax cut through their payroll taxes.

I wonder if one can explain, Mr. Secretary, the equity in that. It just it seems to me to be inequitable. If there were Socrates or Aristotle, they would say perhaps there would be a moral dimension to it, but we do not talk about moral issues in the Congress.

It would just seem to me that it would be totally inequitable if in fact we allow this tragedy to happen. That is, the tax cuts are being paid for by individuals' payroll taxes, and people who are making \$15,000 and \$20,000 are paying tax cuts for people making over \$1 million a year.

Could you please help me with that and perhaps alleviate my concerns and fears about that?

Mr. O'NEILL. Yes. Thank you very much, Congressman Matsui, for your comments.

Let me start with the first data that you discussed, and observe again that while it is true that \$5.6 trillion estimate from last January's, which was broadly agreed by both internal and external economists, has been reduced by \$1.275 trillion over this next 10-year period, by CBO's estimates and by our own. It does not seem to us that it is a good idea, and the President said very directly it does not seem a good idea to him, to raise taxes on the American people.

Now, to the point of what is happening with the Social Security money, let me say again, all of the money collected for Social Security is being credited to the Social Security trust funds. If we had a surplus this year instead of the effect of the war effort and the slowdown in the economy, the extra cash balance represented by a surplus would be used to pay down debt held by the public.

I think it is really important that we not frighten the American people, and especially people that are on Social Security, that anyone has any intent of defaulting on the obligation that the Congress and Administrations since 1935 have warranted to individual Americans that their Social Security will be there.

Mr. MATSUI. Excuse me, but you should tell Mr. Moynihan and Mr. Parsons on the Social Security Commission, because they are the ones who frighten the American public that that money may not be there, even though it is being credited. You even said that yourself.

I am a little troubled by the inconsistency there.

Chairman THOMAS. The gentleman's time has expired.

Mr. O'NEILL. May I make one more point on the distribution of the tax consequences of the tax bill? It is really this: If you look at, under our current tax system, who is paying individual income taxes, 85 percent of all of the tax income from individual income taxes is coming from individuals and families that earn more than \$75,000 a year.

Mr. STARK. That is payroll taxes?

Mr. O'NEILL. I am talking about the individual income tax. That is the subject that we were talking about here.

Chairman THOMAS. The Chair believes part of its responsibility is to allow people who are perhaps watching to understand what is happening here in terms of the dueling charts.

The chart that was up there, this one from 02 to 10, is the impact on the Federal budget. And frankly, whether the taxes are permanent or not, it would have virtually no change on this particular chart. And it shows the portion of the budget surplus which was anticipated as to where it would go to the various categories.

The chart held up by the Secretary of the Treasury are the consequences of this yellow line on the economy in the larger question of revenues coming in to pay for the Federal Government's costs.

So to a certain extent, the charts could be perfectly accurate but they were really showing different things. And the gentleman from Illinois' question about static versus dynamic scoring becomes extremely important at this point, but I will leave that to other Members to inquire.

Does the gentleman from Louisiana wish to inquire?

Mr. MCCRERY. Yes, Mr. Chairman. Thank you.

Mr. Secretary, I believe this chart was distributed by Treasury. It shows the percent of GDP that revenues constitute, that revenues to the Federal Government constitute.

I believe everybody on the Committee was handed this chart, so if you would refer to it, it shows that since World War II, revenues to the Federal Government have averaged about 18 percent of GDP.

When Congress passed and the President signed the tax cut last year, revenues to the Federal Government were at pretty much an all-time high of around 21 percent of GDP.

So it is true that the tax cut reduced the surplus. We knew that. Hello. We wanted to reduce the surplus. The government was taking in too much money. We wanted to return some of that money to the people who earned it. We wanted to let the people who were earning that money keep more of their own money to create jobs, to create prosperity.

Had it not been for that tax cut, the recession we are currently in would have been much deeper, wouldn't it, Mr. Secretary?

Mr. O'NEILL. You are absolutely right.

Mr. MCCRERY. And revenues would have gone down even more, wouldn't they, Mr. Secretary?

Mr. O'NEILL. Absolutely.

Mr. MCCRERY. So those folks who are concerned about the budget, the deficit, the debt, should know that economic growth is the key to the surplus or to the deficit, not some marginal tax rate for some category of income earner. It is economic growth, that is the key.

This chart clearly shows any time we have had a recession since World War II, revenues have dipped below the average line except for—which one, Mr. Secretary?

Mr. O'NEILL. This one.

Mr. MCCRERY. The one we are in right now.

Mr. O'NEILL. Exactly.

Mr. MCCRERY. We are still taking in, even with the tax cut, even with the recession, 19 percent of GDP, 1 percent above the post-war average for revenues to the Federal Government. My goodness, how much do you want the government to take, 25 percent, 30 percent? How much of the very character of our society do you want to change by the government taking more and more and more?

That is why we had the tax cut, to preserve the nature of our economic system, to preserve the system that has made this the best country in the world, which produces the most jobs, the most exports. You name it, we do it. Why? Because of our economic system, because we let people work and keep most of their money.

So, Mr. Secretary, I applaud your Administration for leading us to getting our taxes under control, which we now have pretty much done. We would like to do a little more to help the economy grow more quickly and more robustly as we come out of this recession, but 19 percent of GDP for revenues to the Federal Government it seems to me is not only adequate but is higher than we are accustomed to taking in.

Let us talk about the debt and interest rates real quickly. Is there any historical correlation that you are aware of, Mr. Secretary, between deficits and long-term interest rates?

Mr. O'NEILL. No. As a matter of fact, I think the economic data very clearly shows us that long-term rates are a function of two things: one, the necessary real rate of return to capital; and second, inflation and inflation expectations. It is very clear.

Mr. MCCRERY. And maybe a third would be the money supply.

Mr. O'NEILL. I'm sorry?

Mr. MCCRERY. The money supply would enter into that as a condition of interest rates, but certainly not deficits.

Mr. O'NEILL. Absolutely not.

Mr. MCCRERY. If you look at historical charts showing deficits and draw a line for long-term interest rates, there is absolutely no correlation. So this phony argument about, oh, gosh, if we run a deficit during a recession, which we have always done, we are going to get these long-term interest rate spikes is just nonsense.

So Mr. Secretary, please continue to fight for commonsense economic policy and tax policy for this country, and just maybe we will begin to grow again and the surplus will take care of itself. Thank you.

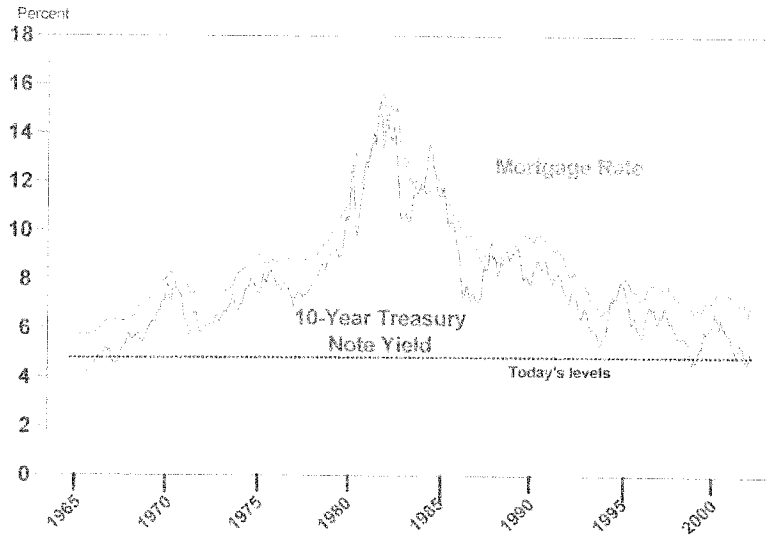
Mr. O'NEILL. Thank you very much. Mr. Chairman, we can make this chart available in paper form to the Committee, too. What this shows is interest rates are at 40-year lows. This chart captures interest rate performance back to 1965 and through the current period.

As I said in my testimony, it is simply not true that interest rates have trended up during this recent period, as you all have voted for tax relief for the American public. The 10-year interest rates are lower than they have been, for a reference basis, by more than 100 basis points.

So indeed, as the Congressman suggests, we believe we are on the right track and we should not be concerned about interest rates and where they are going. Inflation is under very good control at the moment.

[The chart follows:]

Interest Rates At 40-Year Lows



Chairman THOMAS. I thank the gentleman. I think the Secretary could assume that if a chart is worth holding up, it is worth passing out. So if you have any more, we will anticipate it and we will make copies of it and have it available to Members.

Does the gentleman from Pennsylvania, Mr. Coyne, wish to inquire?

Mr. COYNE. Thank you, Mr. Chairman. Welcome, Mr. Secretary, and thank you for your testimony.

In your written testimony today, you stated that the strict fiscal discipline contained in the President's budget is crucial to ensuring that we do not return to systemic deficits of the past. But the administration's budget in fact proposes systemic on-budget deficits, does it not?

Mr. O'NEILL. I would not say the intent is that they be systemic, and indeed, I suspect that—the reason I pointed out in my comments in the exchange with Mr. Stark the \$660 billion worth of so-called technical correction in the 10-year data, it is necessary for us to give you hard numbers that you can look at for outyear periods.

But as I said at the very opening of my testimony, I continue to be an optimist about the U.S. economy, and I will not be surprised if I am here next year to say to you, well, the estimators have changed their minds and the surpluses have come back because our economy is growing at a faster rate than was anticipated in January of 2002.

Mr. COYNE. I don't think one could dispute the fact that every year from 2002 to 2007, the Administration's budget proposes on-budget deficits, excluding—if you want to take into consideration growth in the economy and additional revenue, that is one thing. But the budget as proposed clearly has on-budget deficits from 2002 to 2007.

Mr. O'NEILL. We are assuming on a unified basis we are going back into surplus in 2005.

Mr. COYNE. In my judgment, for what it is worth, that just is not strict fiscal discipline.

Mr. Secretary, last year we talked about a lockbox to secure the Social Security trust funds, and the Administration's budget request now proposes using all of the \$179 billion in surplus Social Security revenues for 2003. What good was the lockbox that we enacted last year?

Mr. O'NEILL. I'm thinking about how to answer your comment about there not being fiscal discipline. The implication of what we have proposed not being fiscal discipline suggests one of two courses, it seems to me: One is to raise taxes, which we are against; and the other is to reduce spending from what the President has proposed, which obviously we do not think is the right thing for the country.

The President has looked at the needs in our situation for prosecuting the war on terrorism and providing better protection for homeland security, and following up on all of the proposals and agreements that we have had together about expanding significantly education and medical care spending. And so the President's judgment is that this is the right combination of fiscal policy for this time, as he sees his responsibilities and as he sees all of the breadth of the engagement of the Federal Government from the perspective of all the people.

And so, again, if this is not fiscal discipline, there are only two ways to get your version of fiscal discipline. One is to raise taxes, and the other is to reduce the spending the President has recommended. We do not favor either one of those.

Mr. COYNE. Well, the President and the Administration are very quick to say that the Democrats want to raise taxes, but I have heard no Democrats say that they want to raise taxes. Now, do you categorize the possible freeze in future tax cuts as a tax increase? Is that what is defined as a raise in—

Mr. O'NEILL. I didn't make the rules, but as I understand it, if you all want to not follow through on the tax reductions that you all agreed to last year, that your own scoring committees would score any change in the effective date implementation as a tax increase. That is not my judgment, that is my understanding of your rules.

So that if you decide that you are not going to follow along and let people have the child credits that are foreordained in the legislation you passed last year, or the marriage penalty relief that you all thought was a good idea, then it is going to show up on your account as a tax increase for the American people.

So I would say that is a tax increase, yes.

Mr. COYNE. Thank you.

Chairman THOMAS. The Chair is somewhat confused now in terms of the charts, because I thought one of the reasons the chart was put out was—the red bar was what is listed as the June tax cut, and if the red bar is big and ugly, you would assume that you would want to do something about the tax cut. Otherwise, I don't understand the meaning of this particular chart.

I don't know that any Democrat has said they wanted to raise taxes, but when we show another chart in which the ugly red bar is the same as the economic consequences to the economy, and it is listed "June tax cut," the assumption is you want to do something with it. And there is only one thing you can do with it, and that is to rescind it.

When you give someone something and then take it away, whatever you want to call it, you have got to go back to the Treasury Secretary's chart to realize that the changes that were made will have a significant long-run positive impact on Federal revenues.

So if no one is advocating a tax increase by virtue of using these charts, the Chair and others would be very interested in what the purpose of the chart was, other than to illuminate the fact that the Congress now has very expensive color copiers which allow us to make colorful displays.

Mr. MATSUI. Will the gentleman yield?

Mr. MCCRERY. Another way to say it is, what is your point?

Chairman THOMAS. The gentleman from Louisiana wants to know, what is your point?

Mr. MATSUI. The point is, we just wanted to show the consequences of the actions of this Administration. Republicans control the House, they controlled the Senate for the first 6 months of the last year, and of course the executive branch is controlled by the Republicans. We just want to show the consequences.

What is going to happen is that we are going to have significant benefit cuts in Social Security as a result of this tax cut and because of the deterioration in the economy. But the tax cut will result in a major reduction in Social Security benefits.

And so that is all we wanted to show. I mean, don't you want to be responsible for your actions? You should be held accountable for your actions.

Mr. MCCRERY. So the gentleman has suggested——

Mr. MATSUI. If the gentleman would all of a sudden be concerned because we wanted to expose the American people to what they are doing——

Mr. MCCRERY. If the gentleman is not proposing an increase in taxes, I would repeat, what is the gentleman's point?

Mr. MATSUI. Would the gentleman listen? I just explained it.

Mr. MCCRERY. The gentleman did not explain it.

Chairman THOMAS. The gentleman wanted to show the consequences of decisions that have been made, signed into law, and the assumption is they don't like them.

Mr. MATSUI. We didn't vote for them.

Chairman THOMAS. The assumption is that there need to be changes made. I believe the point has been well made. Without saying it, the only obvious choice is to raise taxes.

Mr. MATSUI. Regular order.

I just hope the other Members will be able to ask questions. If the Chairman wants to respond every time a Member goes through their questions, we will never let the lower-ranking Members ask questions.

Chairman THOMAS. I think the gentleman should rely on the Chair in terms of allowing the lower-ranking Members. The Chair has introduced procedures at these hearings that have never been utilized in the past, and he, as well as I, having been a lower-ranking Member, remember we never got to ask questions.

Does the gentlewoman from Washington wish to inquire?

Ms. DUNN. Thank you very much, Mr. Chairman. I think we need to get back to the point of this budget, and I appreciate your having helped out some of my neighbors in the Pacific Northwest with your funds for unemployment and coverage of medical benefits. I think that is very important.

We are in a situation where up to 30,000 Boeing employees alone are going to be losing their jobs by the end of this year, and we have tried very hard to help out the companies that are going to be laying people off by some of our tax provisions, but also by adding to the generosity of companies like Boeing with some additional weeks of unemployment and general coverage of medical insurance. Thank you very much for that, Mr. Secretary.

I wanted to—could we have order, Mr. Chairman, please?

I wanted to make a point that seems to have fallen through the cracks. That is, as I read this budget, this budget says that for the next year or two, we will be in a deficit situation, where we projected pre-9/11 and the recession that accompanied that, that actually started in my part of the country in early 2000, that after 2 years we will go back into a surplus position.

What happened when we projected \$5.6 trillion is that we have dropped down now to a 10-year surplus of \$1.6 trillion. That is a point often forgotten in the way people cover this whole situation that has happened to us in the United States, most of which is beyond our control, and as we look ahead and become involved in the very important budget process.

Mr. Secretary, I want to talk to you about one area of this budget that is something I especially appreciate, and that is the speeding up of the tax relief provisions that the President signed in June.

I am particularly happy that you have included a death tax permanency issue here, because I think that is so vitally important. When we see how tax relief can change behavior, and you look at the small business community alone, even though we phase out this death tax over the next 8 years, it still comes back to haunt us 9 months later. They are calling that the suicide area. They are calling that 9 months the time when somebody is going to have to die or pay some form of death tax. And beginning in October of 2010, that tax will come back once more to haunt us, not in its phaseout condition of the year before, but the way it was pre-June when it was signed by the President.

So I would like to ask your impressions of how you think permanency is important, particularly with regard to the phasing out of the death tax; what behavioral changes you expect that we would see since people are still having the same unpredictability, still having to provide for estate planning and so forth?

Mr. O'NEILL. Well, it is my expectation that if we can take away the uncertainty that exists in the legislation the way it was finally agreed last year, that it will have a serious effect on how people conduct their financial affairs in anticipation of what we all know: that inevitably we are going to die and pass on our worldly assets to our heirs and assigns. And the current Tax Code which the reform bill was intended to fix last year induces all kinds of behavior to avoid taxes and try to skip generations, and I think frankly it results in the misallocation of capital that would otherwise pursue a normal good growth and not be driven by tax considerations, but, more substantially, by the expectation of accumulation for current and future generations.

So I think in economic thought, there is no doubt that if we can give a sense of permanency to those who are accumulating wealth in the time between now and when these estate tax provisions would have full effect, and then assure to them that it will not be taken away in 9 months, that behavior will begin to change almost immediately, and many people who now pay very substantial amounts of money to estate planners can save that money and use it for investment, instead of trying to figure out how to cope with the Federal Tax Code.

Ms. DUNN. Thank you.

Mr. Secretary, I wanted to make one last comment. That is with reference to the gentleman from California, who said that the tax relief proposals were aimed at, to paraphrase, "our rich friends."

He is talking about a single schoolteacher who makes \$30,000 a year who is not in the 28 percent tax bracket. For him to consider that individual who cannot even afford housing in the community where she teaches as rich, I think is over the edge.

We have to pay attention to the details as we discuss these things, because the rhetoric can be very hot and very flaming, but it also can be very incorrect, and it can end up in penalizing the people who should be helped out.

Mr. O'NEILL. Thank you.

Chairman THOMAS. The gentlewoman's time has expired. Does the gentleman from Georgia wish to inquire?

Mr. COLLINS. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being with us here this morning.

I have a question about the definition of "displaced workers" as we move forward with the health care benefits and the unemployment benefits in the stimulus package, and hopefully the others on the other side of the hall will get to this package very soon.

I am referring to displaced workers who took voluntary leave from anywhere from 2 to 5 years so that maybe others would not be given a pink slip, but still they are displaced. It is all because of the economy and because of the emergency, because of the war efforts and all, that this came about.

Has this been put on the platter at any point, that displaced workers would include anyone who did take a voluntary unpaid leave?

Mr. O'NEILL. Help me a little bit. I am not sure I understand the question. This is for people who are on unpaid leave, and the question is whether or not they would be covered by—

Mr. COLLINS. They would be covered under the health care benefits, the Consolidated Omnibus Budget Reconciliation Act of 1985 or COBRA payments that we had proposed in the stimulus package just before Christmas.

Mr. O'NEILL. I think not in the version that we favor. What we favor would provide assistance through a refundable tax credit to people who are actually displaced; not those who, as you say, have been in some sort of leave status. This would be for people who actually have been actively employed and then are unemployed subsequent to September 11.

Mr. COLLINS. Well, that is the same thing. These people are unemployed, and there is no guarantee that they would be reinstated.

Mr. O'NEILL. I'm sorry?

Mr. COLLINS. They are permanently unemployed, and there is no guarantee that they would be reinstated. Some just said "I will take leave, unpaid leave," betting on the fact that they may be able to go back to work at some future point in time so maybe some others in a less good situation than they are would not have to be displaced.

I do think they need to be taken into consideration if we go through with the health care benefits that we are proposing.

Mr. O'NEILL. All right.

Mr. COLLINS. One other thing too, Mr. Secretary. It has been said that those who are earning \$15,000 to \$20,000 a year, it is unfair for them to pay for the tax relief for any other taxpayers. Very few people who make \$15,000 to \$20,000 pay any tax. In fact, under the earned income tax credit, most of the people receive back more than their payroll tax in benefits or through a refundable credit.

It is also interesting, the comment you made about 85 percent of the taxes collected come from families with an income of \$75,000 or more per year. The 10-year growth of projections of 55 percent, have you used any projections that would show what would happen with the growth of income had there not been a tax reduction? We all know that with the recession, with the unemployment, revenues would be down. You show it with the——

Mr. O'NEILL. We have looked at, nationally, where would we be if you all had not enacted a tax cut, and it is fairly clear that the depth of the recession and the speed of going into a slow economic period would have been substantial.

As a matter of fact, I think maybe we can account it to just good luck, if you wish, but the action that was taken by the Congress last year that began putting money, incremental money, back into the pockets of the people who earned it in July was fortuitously there, because it significantly softened what otherwise could have been a very sharp down period after the terrorist attacks.

I think one of the reasons that I was more hopeful than almost anybody I know about the possibility of the fourth quarter being positive is because of the expectations I had for the interest rate cuts that Chairman Greenspan and the Fed put in place, and the tax action that you all took, which had begun to infuse the economy with people's money, which they, after all, had earned anyway, at the very beginning, on the 23rd of July, and then flowing

through the economy like a strong current as we were recovering from the September 11 attacks.

So I think while we may not be able to specifically quantify how many jobs we avoided losing because of the actions that you took and the actions of the Fed, I would say the numbers are in the hundreds of thousands, maybe more than that.

Mr. COLLINS. I think it would have been much worse had we not put in place the tax relief, and I think we would have had a much quicker recovery had the other body engaged in truthful actions with the stimulus package.

You know, Mr. Secretary, I have found that one of the major problems that we have here in Washington—and I am a small business guy, have been for 39 years, and always operate on what I refer to as cash flow. I never have called this thing that many have called a “surplus,” surplus. I call it positive cash flow, where at a point in time we were taking in more money than we were spending. The danger part of that is sometimes you get payday-rich and you begin to spend more than you should.

But our problem in this town is that we focus more on the cash flow of the Treasury than we do the cash flow of individuals and of business. And that cash flow of individuals and businesses is where the cash flow of the Treasury comes from.

The old rule of thumb is that the more you leave in the cash flow of the private sector, it has the potential of revolving or rotating itself some seven times. That is where you generate the revenue, the potential new revenues from the economy, is because those dollars will be used and turned over and over. And every time they turn, each entity of government, not just the Federal Government, will benefit from it.

So I think if people in this body and in this Committee in particular would focus more on the cash flow of their constituency, the cash flow of the businesses that provide the jobs for their constituency, then you would see a better cash flow in Washington as a result, instead of sitting up here day after day trying to drive wedges between people back home because of their own political philosophy and their seeking of political power.

Thank you, Mr. Secretary. I think you have done a very good job this morning. We appreciate your answers.

Mr. O'NEILL. Thank you.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. Welcome, Mr. Secretary. I think the public would like some clear, simple answers, so let me ask you a few questions.

Isn't it correct that the budget as proposed would use Social Security funds each of the 10 years?

Mr. O'NEILL. No.

Mr. LEVIN. Yes?

Mr. O'NEILL. No.

Mr. LEVIN. No?

Mr. O'NEILL. The Social Security funds, as I have said repeatedly—

Mr. LEVIN. I didn't say about crediting.

Mr. O'NEILL. The Social Security funds will be credited to the Social Security accounts.

Mr. LEVIN. OK. You say "credited," but let's be clear. In terms of the surplus, the surplus in the Social Security funds would be reduced every year, would they not?

Mr. O'NEILL. No. It won't be reduced at all.

Mr. LEVIN. Would there be—

Mr. O'NEILL. Maybe we should talk about income and balance sheets. Maybe your point is that we have an unfunded liability. I would stipulate that we have maybe a \$10 trillion unfunded liability for Social Security which eventually we must deal with.

Mr. LEVIN. And it would be increased every year under this budget?

Mr. O'NEILL. No. It won't be increased by the budget numbers. It will be increased as we have more people earning more money and earning credits, but it does not have anything to do with the revenue flow.

Mr. LEVIN. Let me put it this way, then. You are saying that the unified budget goes into surplus after a number of years, right?

Mr. O'NEILL. Let me say this to you: If we kept books in a way that made clear what our purposes are, we would have a cash book, and it would largely be what we call the unified budget numbers. It shows the total inflows and outflows of the Federal Government.

To the Members, the comment of Mr. Collins, it does make a lot of sense to pay attention to cash, because if you do not have enough cash, it means you have to borrow some. But—

Mr. LEVIN. Mr. Secretary, I don't think anybody is going to understand this. We had a unified surplus projected of \$5.6 trillion, isn't that correct?

Mr. O'NEILL. We had.

Mr. LEVIN. Now we have a unified surplus that has been dramatically reduced, correct?

Mr. O'NEILL. Right.

Mr. LEVIN. What that means is that we are going into the surplus, and the Social Security fund—it is being reduced. It has to be.

Mr. O'NEILL. No. We are going into a position where we are going to borrow some money because we are not taking enough money in total to pay all of our debts.

Mr. LEVIN. I will use your words: We are borrowing Social Security monies. We are borrowing monies that come in for purposes of Social Security.

Mr. O'NEILL. We are borrowing money from the general public to fully service current obligations.

Mr. LEVIN. These are Social Security payroll taxes, are they not?

Mr. O'NEILL. And it is going into the Social Security Trust Fund.

Mr. LEVIN. But we are using those monies for other purposes.

Mr. O'NEILL. Again, let me say, we have got arguably an \$11 trillion contingent liability for Social Security.

Mr. LEVIN. No. We had a projected \$5.6 trillion surplus. That now has been diminished dramatically. Half of that surplus was Social Security, and now we are below that amount, so we need to tell the public straight out that under this budget, Social Security and Medicare funds are being borrowed.

Mr. O'NEILL. The alternative is to invest them, to in effect buy back debt held by the public. We are mixing concepts here, and I

think the American people would be really well served if we would not mix concepts. I am saying to you that we——

Mr. LEVIN. I will go back to concepts. Let me just read to you. If we lockbox Social Security, as the President said we should do, effectively use it to pay down the public debt——

Mr. O'NEILL. Correct.

Mr. LEVIN. And you all want to do Medicare, too; if that is the way it comes out, that is fine. We still have got, after implementation of the President's proposal, \$1.5 trillion available, or more than 25 percent of the total projected surplus.

So essentially you said if we wanted to lockbox those monies, fine. Paying them down, paying down the public debt, that is no longer happening with those monies, isn't that correct?

The lockbox has been unlocked. Why don't you simply admit it? Has the lockbox been unlocked?

Mr. O'NEILL. Well, I think——

Mr. LEVIN. Yes or no.

Mr. O'NEILL. I don't think it is a simple yes or no answer. The answer is, Social Security funds are always going to be used for Social Security and only for Social Security. And yes, we have cash coming in, and on balance, we are having to borrow a little bit of money this year because of the war and because of the slowdown in the economy.

Mr. LEVIN. So we are borrowing—I don't mean to interrupt you, except the public needs a straight answer. We are borrowing that money, and as the chart showed, a small part of it is for defense. We are borrowing that money, so why don't you say so? And we are borrowing it for each of the 10 years.

And then you say the deficits don't matter, and that is a shocking change. I just read to you, and I will finish what Mr. Greenspan had to say: “. . . over the past year, some of the firmness of long-term interest rates, probably as the consequence of the fall of projected budget surpluses, including Social Security, and the implied less rapid paydowns of Treasury debt.”

It is astonishing that somebody comes here—and Mr. McCrery says it is nonsense that surpluses or deficits matter, and you come here and say that fiscal discipline, the deficits versus surpluses, are irrelevant. Are they irrelevant? Is Mr. Greenspan totally wrong?

Is Mr. Rubin, your predecessor, who castigates this Administration for the loss of—he says, “this country is ill-served by abandoning fiscal discipline, and this budget abandons fiscal discipline. It is the opposite of what was accomplished in the 1990s.” Is Mr. Rubin dead wrong?

Mr. O'NEILL. The implication, Congressman, of your remarks is that you think we should either raise taxes or reduce spending for the things the President has recommended.

The President believes under the circumstances we have right now, what we have put before you is the height of a responsible proposal because it takes care of prosecuting the war on terrorism, it takes care of heightened needs for homeland security to protect ourselves, and it takes care of lots of other spending to a total of over \$2.1 trillion, and it does not raise taxes, which is the——

Mr. LEVIN. Admit you are borrowing from Social Security to do that.

Mr. O'NEILL. We are not borrowing from Social Security, I'm sorry.

Chairman THOMAS. The gentleman's time has expired.

Fully understanding the potential wrath the Chairman's comment may unleash, the Chair understood the gentleman from Louisiana not to say that long-term interest rates and deficits don't matter, but in fact there is no correlation between the two, was what the Chair thought was the thrust of the gentleman from Louisiana.

Does the gentleman from Ohio, Mr. Portman, wish to inquire?

Mr. PORTMAN. I thank the Chair. There have been a lot of confusing statements made that I think have misled people who are trying to figure out what we are talking about here.

I think Chairman Greenspan is exactly right in the sense that the most important single thing is economic growth, and that is the way we are going to solve our Social Security and our Medicare challenges.

Just to be clear, the tax relief which was passed last spring that some are suggesting was not a good idea, and therefore should be repealed, is about economic growth.

Mr. Secretary, you said in your testimony something about who benefits from the tax cuts. And could you talk just a little about those engines of economic growth who benefit from the tax relief, particularly the two highest rate reductions?

Mr. O'NEILL. Well, as I said in my testimony, and maybe I could amplify it a little bit with a more specific example, there are 33 million small businesses and entrepreneurs out there who are caught by these highest tax rates because they pay taxes on an individual basis. And last spring, after you all passed the tax relief bill, as is my custom, we had groups of people in to talk with us about what is going on in the economy.

I thought it was a really dramatic example of the importance of this point, with one person who owned a florist shop. His comment was: "Because of the tax changes you all have made, and because of my position in paying high individual rates, with your changes I am going to be able to hire one additional person." Just one additional person.

I think that this is really a telling thing, that job growth in this country occurs one at a time, and that tax rates that we pull in here from those entrepreneurs reduce the potential and possibility of job growth, which is, after all, the engine of revenue accumulation here in Washington.

The thing that is really important and not to forget is that we can have more revenue here, as my chart shows we will, if we can give encouragement to those who create jobs and pay taxes.

Mr. PORTMAN. I think that is the key. You talk about 80 percent of the growth of the benefit in the top two rate reductions go to small businessowners and entrepreneurs. You also talk about the fact that we are now paying well above the historic average with regard to taxes, well above the 18 percent. You also talked about distributional limits.

But what you did not say is at the end of all these tax cuts, the wealthy will be paying a higher proportion of the income tax. You are talking about how people making \$75,000 bucks or more pay

the vast majority of taxes, about 80 percent of the income taxes. Will they be paying more or less at the end of the Bush tax cuts?

Mr. O'NEILL. The higher income people will be paying a—

Mr. PORTMAN. They will be paying a large portion. We have historical high tax rates, a distribution that is even more progressive, and we are going to have economic growth that results from it. That is the point.

With regard to Social Security, there have been a lot of misleading statements. To make something very clear, people have been saying we are dipping into the Social Security trust funds to pay for the cost of the war, to pay for this tax relief that is so important to economic growth. We know that is not true.

Let's just be very specific here. Can you explain the difference between the Social Security surplus and the Social Security trust funds?

Mr. O'NEILL. Well, the Social Security Trust Fund is a trust that you all have established, and most significantly, it is a warrant to the American people that the word of the U.S. Government is good, and that as people mature into Social Security recipient status, that they will get what they expected to get.

The President has said over and over again that this is a trust that will never be breached, and I think you all agree with that; that we are going to make good on the commitment that has been made to American citizens that when they get to retirement age, Social Security will be there for them in the form they expect it.

Mr. PORTMAN. The only way to change that is for Congress to take action to either reduce the benefit or change the revenue in some ways. Is anybody considering that? Is that in your budget?

Mr. O'NEILL. I cannot believe anyone would seriously consider—

Mr. PORTMAN. Before we scare those seniors and near seniors that may be watching us today, we are not talking about the trust fund. It is not touched by this. If there had been more surplus built up because the economy continued to do as well as it would have been doing, how would that surplus have been used?

Mr. O'NEILL. Would have been used to reduce debt held by the public.

Mr. PORTMAN. To pay down debt. That is the difference. I think it needs to be made clear. Income to Social Security trust funds can only be used for the purposes designated by law, which is Social Security benefits and funding the Social Security Administration. Isn't that the way the law currently reads?

Mr. O'NEILL. Yes, sir.

Mr. PORTMAN. I think it is very important, Mr. Chairman, that we not talk about dipping into the Social Security trust funds, because we are not doing that. We have made that very clear. I also would make the point again that it is incredibly important that we grow this economy. That is the single most important thing. That is what the tax relief is about. We would be deeper into recession if we didn't have it. I appreciate your testimony, Mr. Secretary.

Mr. O'NEILL. Thank you.

Chairman THOMAS. Does the gentleman from Maryland wish to inquire?

Mr. CARDIN. Thank you, Mr. Chairman. Mr. Secretary, welcome.

I want to do something that is rarely done here. Rather than put up a chart to start off with, Mr. Chairman, I am going to go through the actual book, the Congressional Budget Office book, page 161, which gives the backup information to a chart that was used to indicate that we are still very high on the total number or total revenues we receive as a percentage of the gross domestic product.

[The table follows:]

APPENDIX F HISTORICAL BUDGET DATA 161

Table F-4
Revenues by Major Source, 1962-2001 (As a percentage of GDP)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscellaneous Receipts	Total Revenues
1962	8.0	3.6	3.0	2.2	0.4	0.2	0.1	17.5
1963	7.9	3.6	3.3	2.2	0.4	0.2	0.2	17.8
1964	7.6	3.7	3.4	2.1	0.4	0.2	0.2	17.5
1965	7.1	3.7	3.2	2.1	0.4	0.2	0.2	17.0
1966	7.3	4.0	3.4	1.7	0.4	0.2	0.2	17.3
1967	7.6	4.2	4.0	1.7	0.4	0.2	0.3	18.3
1968	7.9	3.3	3.9	1.6	0.4	0.2	0.3	17.6
1969	9.2	3.9	4.1	1.6	0.4	0.2	0.3	19.7
1970	8.9	3.2	4.4	1.5	0.4	0.2	0.3	19.0
1971	8.0	2.5	4.4	1.5	0.3	0.2	0.4	17.3
1972	8.0	2.7	4.5	1.3	0.5	0.3	0.3	17.6
1973	7.9	2.8	4.8	1.2	0.4	0.2	0.3	17.6
1974	8.3	2.7	5.2	1.2	0.3	0.2	0.4	18.3
1975	7.8	2.6	5.4	1.1	0.3	0.2	0.4	17.9
1976	7.6	2.4	5.2	1.0	0.3	0.2	0.5	17.2
1977	8.0	2.8	5.4	0.9	0.4	0.3	0.3	18.0
1978	8.2	2.7	5.5	0.8	0.2	0.3	0.3	18.0
1979	8.7	2.6	5.5	0.7	0.2	0.3	0.4	18.5
1980	8.9	2.4	5.8	0.9	0.2	0.3	0.5	18.9
1981	9.3	2.0	6.0	1.3	0.2	0.3	0.5	19.6
1982	9.2	1.5	6.2	1.1	0.2	0.3	0.5	19.1
1983	8.4	1.1	6.1	1.0	0.2	0.3	0.5	17.4
1984	7.8	1.5	6.2	1.0	0.2	0.3	0.4	17.3
1985	8.1	1.5	6.4	0.9	0.2	0.3	0.4	17.7
1986	7.9	1.4	6.5	0.7	0.2	0.3	0.5	17.5
1987	8.4	1.8	6.5	0.7	0.2	0.3	0.4	18.4
1988	8.0	1.9	6.7	0.7	0.2	0.3	0.4	18.1
1989	8.2	1.9	6.6	0.6	0.2	0.3	0.4	18.3
1990	8.1	1.6	6.6	0.6	0.2	0.3	0.5	18.0
1991	7.9	1.7	6.7	0.7	0.2	0.3	0.4	17.8
1992	7.7	1.6	6.6	0.7	0.2	0.3	0.4	17.5
1993	7.8	1.8	6.5	0.7	0.2	0.3	0.3	17.6
1994	7.8	2.0	6.6	0.8	0.2	0.3	0.3	18.1
1995	8.1	2.1	6.6	0.8	0.2	0.3	0.4	18.5
1996	8.5	2.2	6.6	0.7	0.2	0.2	0.3	18.9
1997	9.0	2.2	6.6	0.7	0.2	0.2	0.3	19.3
1998	9.6	2.2	6.6	0.7	0.3	0.2	0.4	19.9
1999	9.6	2.0	6.7	0.8	0.3	0.2	0.4	20.0
2000	10.3	2.1	6.7	0.7	0.3	0.2	0.4	20.8
2001	9.8	1.5	6.8	0.7	0.3	0.2	0.4	19.6

SOURCE: Congressional Budget Office

Mr. CARDIN. My reason for going to actually the source document is to sort of walk through this for a moment to show that it is true that income taxes over the last 40 years have remained somewhat constant as a percentage of our GDP. Corporate taxes have actually been reduced by about 50 percent during that period of time. And the big loser—or the big increase—has been on the social insurance taxes, which have doubled in that same period of time.

I mention that because if you want to look at why we are having a high percentage of revenue, it has mostly been the growth in the social insurance programs, Social Security and Medicare; and I think that is why many of us are very concerned that, when we start looking now at the projections, we see that the surpluses that are generated, as Mr. Levin pointed out, by Social Security, that many of us last year thought would be used for a solution to the Social Security problem is now off the table. Because we don't have those dollars available to invest in Social Security.

Mr. Secretary, I understand the one chart that we put up that talks about congressional action, what we did last year. We put that up just to point out that what Congress did last year, in regards to the projected surplus, about 80 percent was the tax cut; and that is why we lost the projected surpluses and we are now in deficit. Twenty percent was basically the war effort, increased spending. But 80 percent of what we did last year, what Congress did last year, was the tax cut.

Now, Mr. McCrery said, why did we bring that up? I think it is at least instructive as to what we should do this year. What are we going to do this year? Now, first off has been the stimulus package. Are we going to reduce corporate taxes more? Is that what we plan to do? Or are we going to look at additional spending as part of the unemployment insurance? Or, as you point out in your statement, you support extending uninsurance—UI benefits and providing temporary relief for workers who have lost their insurance. I commend you for that.

But why haven't we brought up a bill by total agreement now just on UI? In every recession we have brought forward a bill to increase UI benefits. You know and I know that that money will be put right back into the economy. It is the right thing to do, it stimulates the economy, and yet it is being held hostage for a larger stimulus package. Make no mistake about it. It is being used to try to get additional corporate tax reductions.

I think we should work on all these issues. But in the meantime we passed a bill for the airlines, we are in the process of passing a bill for the insurance industry, we passed a lot of money to help New York, and we still haven't done anything for displaced workers.

I implore you, as we go through this process, talk about what Congress can do. Try to at least spin out the people who have really been left out here, the displaced workers. Don't get that tied up in the politics of additional tax cuts. Because that is controversial. Many of us were told last year that everything was going to be all right as long as we passed this tax bill. Many of us said we thought the projections were wrong. Well, you made 6 or \$700 billion of

technical adjustments since last year. That means we made some mistakes last year in projecting the surplus. So we know we have a problem with displaced workers.

Why can't we get along with and get that done now by agreement? I can assure you the Democrats are willing to work with the Republicans and move out a separate bill on UI. Why can't we do that at least? Isn't that the right thing to do?

Mr. O'NEILL. Congressman, I would remind that on October the 5th the President said he thought we should have a stimulus bill, and he spelled out the components that he thought were important to deal with: Include those people who were directly affected by the events of September the 11th, including those who were displaced workers, and to deal with those who had reduced incomes and to provide some basis for additional job creation. So I think the President has been very clear and we have worked very hard with this Committee, with the Chairman of this Committee through the month of October and November and December with the belief that it was necessary to take action on a stimulus bill and what we call an economic security package.

The House passed versions of this twice, and we simply could not get the Senate to agree to determine——

Mr. CARDIN. I would suggest the Senate would be willing to take up a UI package by itself.

Let me also suggest there is a \$35 billion surplus in the tax. The money is sitting out there. It is available. It is temporary. It is immediate. And we have people now that have exhausted their regular benefits that are no longer getting unemployment insurance because Congress has not acted on this subject. We need your help. We need your leadership. Divide that out as we did for the airline industry. Divide that out as we are doing for the insurance industry. It was right when we did it for the airline industry. It was right what we are doing for the insurance industry. But the displaced workers, it is wrong that we haven't taken action and have separated out their issues.

Thank you, Mr. Chairman.

Mr. O'NEILL. In December, I truly believe that if Senator Baucus had been free to bring our work to a conclusion we would have passed stimulus before the Congress went home at the end of December. And if we had been able to do what at least some important Members of the Senate had wanted to do, we would have passed terrorist risk insurance, too, which we failed to do. So there is no doubt we need action in these areas.

I must tell you I think we worked with every good faith and every good intention with the direction from the President that he wanted these things done. We simply couldn't get them done in the Senate.

Chairman THOMAS. Thank the gentleman.

Just for purposes of clarification, the gentleman used two phrases in regard to the stimulus: to "reduce corporate taxes more," and then you said "additional corporate tax reductions." The gentleman didn't mean to imply, did he, that last year's tax reduction package affected corporations?

Mr. CARDIN. No. If the Chairman would yield, I was referring to the historic reductions over the last 40 years of corporate taxes, which have been reduced by about 50 percent.

Chairman THOMAS. Thank the gentleman. There was some confusion on the Chair's part because, as everyone knows, there were no corporate tax reductions in last year's package.

The gentleman from Pennsylvania, Mr. English, wish to inquire?

Mr. ENGLISH. Yes.

First of all, Mr. Secretary, I would like to thank you for your demeanor at this hearing. In the face of some difficult questions and sometimes rather partisan lines of questioning, I think you have offered the American public some simple but intellectually honest answers. I think you have added a great deal to the debate by doing so.

I would like to start my questioning by seeking a little further clarification. You are, I know, a student of economic history. Has this country ever run a surplus in wartime?

Mr. O'NEILL. No.

Mr. ENGLISH. Has this country ever run a surplus during a recession?

Mr. O'NEILL. No.

Mr. ENGLISH. I wonder, did this country not try to run a surplus in the early part of the Great Depression and at that point we saw the negative effect going into a surplus of trying to—of going into a serious recession of trying to run a surplus? The lessons of history suggest that maybe we should be running a modest deficit now. I am very comfortable with what the President has proposed.

Now, I am delighted that your budget continues to accommodate—Mr. Chairman, I am not sure the Committee is in order right now.

Chairman THOMAS. The Committee will come to order.

Mr. ENGLISH. Regular order. Thank you.

Getting back to my line of questioning, Mr. Secretary, I am delighted to see that in the President's budget you have continued to accommodate a stimulus package. Now we have heard some statements made here today, but the fact is the House has passed a stimulus package that was intended to provide direct assistance to workers, improve their unemployment benefits and I think at a very difficult time provide some assistance to working families.

We have heard it suggested that the Administration should drop its support for stimulus in order to maintain those parts of the package that only provide assistance to workers. But I represent a district which being—having spent time in Western Pennsylvania you know is heavily manufacturing, is going through a much deeper recession right now than the rest of the country. Looking at the stimulus package, could you comment on the importance of some of the corporate provisions that are being dismissed on the other side? Specifically, does not the expensing provision help manufacturing firms like we have in Northwestern Pennsylvania, many of which are export oriented?

Mr. O'NEILL. Absolutely. In fact, you know, I think the point is—I prefer not to say these are corporate related—these are business related. As I observed earlier, the real engine of economic growth in this country is small firms. All firms would benefit by being able

to accelerate depreciation. As the comment was made earlier for those of you who have been in business or understand how business works, this would produce free cash flow, right now, either to protect jobs that are already out there or to add jobs for those firms that are seeing increased demand.

There is no doubt that we should give this burst of assistance to business organizations so that they can attend to keeping and increasing job availability so our revenue can go up at the Federal level, not down. As you observed, we do not believe that it makes sense to raise taxes in a slow economic period and for the sake of an accountant's surplus.

Mr. ENGLISH. Specifically on that point, having been the Chief Executive Officer of a large manufacturing concern, is it not true that the companies that benefit from an expensing provision are precisely those companies which in a recession are making a heroic effort to invest back in their productionline, improve their productivity, and work their way back to profitability?

Mr. O'NEILL. Exactly right.

Mr. ENGLISH. By utilizing those provisions aren't they actually reducing their bottom line? They are not actually seeing a direct benefit. What we are seeing here, is it not true, that the Tax Code gets out of their way when they make critical capital investments that create jobs. So is this not a tax incentive for job creation in the purest sense?

Mr. O'NEILL. It preserves and creates jobs going forward.

Mr. ENGLISH. My time has expired but, again, Mr. Secretary, I thank you for taking the time to come here and offer I think a little bit of clarity in the fog.

Mr. O'NEILL. Thank you.

Chairman THOMAS. Thank the gentleman for having his questions and the answers remain within the 5-minute window. The gentleman from Washington wish to inquire?

Mr. McDERMOTT. Yes. Thank you, Mr. Chairman. I really appreciate your having such a fine hearing because we don't usually get much out of these hearings. They are kind of PR events.

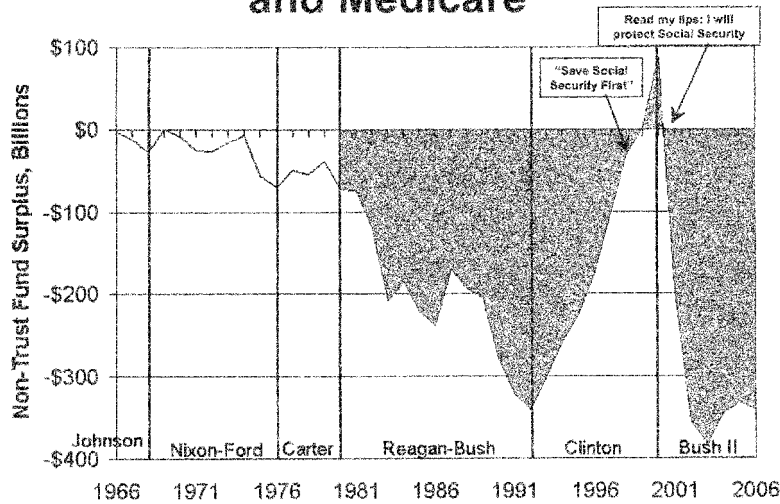
What I want to thank Mr. O'Neill for is admitting to Ms. Dunn that the real point of the \$600 billion tax cut is to slide the estate tax out the door for the future, that it will change all the planning that is done by all the people on the top of the society. It is very good that you would admit that to us.

The second thing that is good is that you admitted to Mr. Levin that we are going to borrow from Social Security. At least we got that out of you. Oh, now you are taking that back. So you are not even going to tell us that you are borrowing the money that is coming in for Social Security in this unified budget.

But I want to go a little bit further and tell you why we keep hammering on this issue. This chart shows what happened in the Reagan years. That first blob of red is when they made a cut and had a military buildup at the same time, and it went down for the whole period of the 12 years. The green is what happened during the Clinton Administration, and we just barely got out of it, and now you are taking us back to the same place.

[The chart follows:]

Republicans Raid Social Security and Medicare



Mr. McDERMOTT. We heard—when I came to Congress in 1988, I heard, take Social Security off budget, stop stealing from Social Security, the Democrats are stealing from Social Security; and now you are doing exactly that. Now, why is that important? Let me tell you why it is important. The Enron Corporation went belly up and left thousands of people out there with nothing but their Social Security. And you said that you are an optimist. We said we would count how many times you said optimist. You said nine times you are an optimist.

The fact is that it is hard to be optimistic if you really look at what is happening to, say, United Airlines. We gave them \$15 billion to save the airlines, and here they are talking about going into Chapter 11.

Now, what comes out—you know why they are going to have trouble doing that of course is that it is an Employee Stock Ownership Plan. Because all the pilots and all the mechanics have got their money tied up in that company, all their future. The only thing they know they will have is their Social Security. Because if it goes into Chapter 11 they could lose it all. They could lose it all.

You can say, well, yeah, companies go into Chapter 11, and they come out. Yeah, like Eastern Airlines and Braniff and Pan Am. You can go right down the list of companies that went into Chapter 11 and didn't come out. So for these people out there who have been working all their lives in good-paying jobs, they are going to wind up with their Social Security or nothing.

So when you say that you are going to do this, it is very hard for me to understand how do you explain to the American people

that in 2008, when we will have a new President, one way or another, we are going to have the bulk of the 40 million baby boomers starting onto Social Security. We all know that. And if you were running a major company like an aluminum company or something you couldn't get away with taking the pension funds and giving them as stock dividends to your board and your executives. You would—well, we will see what happens to Enron. That is what they did. They gave stock dividends, they gave options, they gave it all away to the guys on the top, and the guys on the bottom got stuck.

If you were running a company you would be up here in one of these four hearings that are going on on the Hill today about what Enron did. But as a government official you can come up here and say, well, we are going to ignore what is happening. We can see it in 2008 coming. The average retirement age today is 62, and that is when the baby boomers start coming. How can you say that this borrowing from Social Security somehow isn't going to have to be paid for right at the time when this thing gets the worst and you are giving out \$600 billion more in taxes? You have got people showing up for the only check they are going to have for their senior years. How can you do that? Where is your planning for how you are going to pay off those moneys that you have taken out of the Social Security fund and put in?

Mr. O'NEILL. Well, let me say again we haven't taken any money out of the Social Security trust fund.

But let me ask you a question, if it is appropriate for me to do that, Mr. Chairman. If I suggest that I infer from what you are saying is that we should put the contingent liability of the Social Security and all of their funds on the budget, I would buy that. Is that what the Member is recommending, that we begin running a balance sheet that shows the long-term obligation? I would agree with that.

Mr. McDERMOTT. You can't have it both ways.

Mr. O'NEILL. I am happy to have it that way.

Mr. McDERMOTT. Oh, sure. But that would show your irresponsibility pretty quickly.

Mr. O'NEILL. It would show that we have run a convention since 1935 of using current payroll taxes to pay those who are already retired. I don't think there is any dispute about that.

I think people who are students of this subject know that we together, not just the Administration but the Federal Government, as represented by Administrations and Members of Congress, are going to have to make reforms in Social Security. And I think not just to deliver what we promise, because I have no doubt you all will never, ever renege on the commitments that you have made collectively to the American people about their Social Security benefits, but there is no doubt we are going to have to have reform.

The President has said he believes that reform should move us toward a system of wealth accumulation; and he appointed a very wise, I think, and well-experienced bipartisan commission that worked on the subject last year and made some proposals. And the President has said we need to have an engagement and a conversation with you all about specifically how to move forward on this subject. So you know, again—

Mr. McDERMOTT. Mr. O'Neill, that commission suggested cutting benefits.

Mr. O'NEILL. I don't think that is—I think they looked at a number of different alternatives.

Mr. McDERMOTT. What other alternatives?

Chairman THOMAS. The time of the gentleman has expired. We can't get into that question. We will get into the question as we have hearings on Social Security directly.

I do have a question to the gentleman from Washington on his chart. There is no indication of where it came from. My question has to do with the comparisons between years on money. Are these dollar amounts adjusted for inflation?

Mr. McDERMOTT. It came out of the CBO figures. We took—the whole thing was done by the Budget Committee using CBO figures. So if there is some problem the gentleman can talk to CBO about it.

Chairman THOMAS. The gentleman assumes they are adjusted for inflation or does not?

Mr. McDERMOTT. You wouldn't think the CBO would put things out that weren't adjusted for inflation, would you?

Chairman THOMAS. I understand the gentleman is now shoveling this chart off to the CBO once I asked a question about it. Because the Chair could also indicate that, if the gentleman would look prior to 1994, that the Democrats controlled Congress for the entire time that Social Security was going into the yellow and the red. It is only when the Republicans gained the majority in the House that it was turned around. That chart would show exactly the same results.

So the Chair is trying to understand what it is that the gentleman is producing. If he now says he has no responsibility for this chart and it is CBO, the Chair has a hard time believing that it was structured quite this way by CBO.

Mr. McDERMOTT. Mr. Reagan had no impact. That is what you are telling us. That the Congress sat here and did it all by themselves, and Mr. Reagan just sat down there and twiddled his thumbs?

Chairman THOMAS. No. The Chair is simply saying that, under the Constitution, all revenue originates in the House. The gentleman just dismissed the control of the House by the Democrats. I believe it needs to be looked at in a more sophisticated way than this chart indicates. We hope we will do that during the hearing on Social Security, because, frankly, we are running out of time, and we need to quit approaching this from a partisan point of view and begin to look at societal solutions.

The gentleman from Arizona wish to inquire.

Mr. HAYWORTH. I thank the Chairman for the time.

Mr. Secretary, thank you for coming. Though we may have had our distinctions somewhat publicly in the past, I would like to publicly commend you for your grasp of issues and for this morning again coming through a somewhat cantankerous if not hostile form of questioning from some of my colleagues.

Indeed, Mr. Secretary, as I look at the plethora of charts, before I ask you a question, there is one question I just need to ask my colleagues with a show of hands. Does anyone on this Committee

dias, anyone here at all, want to raise taxes? If you do, just raise your hand. It is a philosophical question.

When all the charts are brought out to talk about how the world would be if we had a tax increase or we left taxes there, the clear implication to this Committee and the American people is that some folks in this room want to raise taxes. Now, either you do or you don't. You are telling us now here on the public record, no hands go up, so apparently you don't want to raise taxes. Thank you for that.

Mr. Secretary—

Mr. RANGEL. Mr. Chairman, if we are—

Mr. HAYWORTH. Regular order, Mr. Chairman.

Chairman THOMAS. The gentleman from New York is complaining that we are now doing equal demagoging, and he is concerned about that. If the gentleman would inquire about that.

Mr. RANGEL. If you agreed with the Chair, put up your hand. No hands go up. Let the record indicate that no one agrees with the Chair.

Mr. HAYWORTH. Delightful. Mr. Secretary, seeing the actions of my friend remind me of the actions or inactions of the Senate Majority Leader, Mr. Daschle, who complained that the tax relief was the source of all this problem but when push came to shove said oh, no, we don't want to raise taxes. Although I note also he is going to resort to, apparently, some floor maneuvers to yet again do nothing on the economic security package.

Mr. Secretary, in your opinion, if we had passed this economic security package in December as it looked like we could have done, where would the American economy be today?

Mr. O'NEILL. I think if we had acted in October I suspect we would have avoided tens of thousands of job losses that occurred because we didn't act. And I have no doubt that, with the components that were in the House-passed bills, people that you had to face when you went home in December who had exhausted their 26 weeks worth of unemployment insurance would have had a continuation of benefits. It must have been really difficult to explain to them why we couldn't do it here in Washington.

So I have no doubt we would have been better off, and it would have been measured in macroeconomic terms but, more importantly, it would have been measured in the lives of individual people out there who were laid off or unable to find work because we couldn't get our act together here in Washington. Most particularly, the other side of the Capitol couldn't act.

Mr. HAYWORTH. Mr. Secretary, I appreciate you coming down. It is interesting to hear some folks talk about holding certain portions of this hostage. I just find the irony that the Senate majority leader, who apparently champions the causes of the downtrodden, continues to delay action on this, thereby hurting the very people he purports to help.

Mr. Chairman, thank you for the time. Mr. Secretary, thank you for your answer.

Chairman THOMAS. Thank the gentleman for his brevity. The gentleman from Wisconsin, Mr. Kleczka, wish to inquire?

Mr. KLECZKA. Thank you, Mr. Chairman.

The question that was just asked is why wasn't the unemployment compensation extension granted by now? And the reason, as you know, Mr. Secretary, is that the Administration and Republicans insisted on tying in with that unemployment extension massive tax breaks for the business community under the guise of stimulus.

One of the original bills that we passed out of this House, and I don't know if it came before the Committee, was a repeal of the alternative minimum tax for corporations, one which was retroactive back to 1986. So the effect of that policy was to give corporations like Ford and IBM a check from the Federal Government of \$1.4 billion; General Motors, \$800 million; Enron, \$250 million. That is why unemployment compensation extension did not pass, because it was tied in with these tax breaks which are not justified. And as the Washington Post said, the only stimulus provided for in that bill was to stimulate campaign contributions to the supporters of that tax cut.

You know, we have talked a lot about Social Security this morning. I find it just totally amazing that when my Republican colleagues were talking about a lockbox, locking away the balance of Social Security, locking away the balance in Medicare, that we were told by the Republicans that you Democrats spent the money, you spent the money, and you put worthless IOUs into the trust fund.

Well, my Lord, how things have changed. Now the Republicans have taken over. The Republicans have the Administration. Now those things aren't happening anymore. Now we are borrowing and not spending it, and—as evidenced by the Secretary's own words—and these aren't worthless IOUs anymore, they are credits to the trust fund. My Lord, how things have changed in 2 years—or a little over 1 year, I should say.

Mr. Chairman, I would ask unanimous consent to put in the record two articles that appeared in the Los Angeles Times. Both are dated Tuesday, February 5th.

Chairman THOMAS. Without objection.

Mr. KLECZKA. The first one is entitled, Budget Sells Social Security Down Red Ink River; and the first paragraph indicates, in the budgets he delivered Monday President Bush relies on one source of new money more than any other to pay for his proposals: the trillions of dollars in Social Security funds being set aside for the start of the baby boom retirement. That is the one article.

The article also has contained in it a chart which is almost identical to the one my colleague, Mr. McDermott, put up which was not agreed to by some of my Republican colleagues. But this one—it is the same kind of a chart—it indicates the source is the Office of Management and Budget.

[The article follows:]

Los Angeles Times.

BUSH BUDGET PLAN

Budget Sells Social Security Down Red Ink River, Critics Say

By PETER G. GOSSELIN

TIMES STAFF WRITER

February 5 2002

WASHINGTON—In the budget he delivered Monday, President Bush relies on one source of new money more than any other to pay for his proposals: the trillions of dollars in Social Security funds being set aside for the start of the baby boom retirement.

Although Bush and his aides warned in advance that the war on terror and the need for homeland defense would require dipping into the Social Security surplus and running deficits for a few years, the dimensions of what the administration had in mind were not apparent until the unveiling of the \$2.13-trillion spending plan for fiscal 2003. The measure took the breath away from some Democrats and independent analysts.

“The president is requiring the use of Social Security to pay for the normal operations of government,” said Robert D. Reischauer, president of the nonpartisan Urban Institute and a Washington budget veteran. “That’s the most significant, and largely unrecognized, change he’s making.”

Declared Citigroup vice chairman and former Clinton administration Treasury Secretary Robert E. Rubin: “This country is ill-served by abandoning fiscal discipline and this [budget] abandons fiscal discipline. It’s the opposite of what was accomplished in the 1990s.”

To be sure, that opinion was not universally shared, and no one claimed there was any danger to current retirees’ benefits. Former Democratic Sen. Daniel P. Moynihan, who cochaired a recent commission on Social Security for Bush, said: “My own view is that this is a war budget. This is a national emergency and the president is responding.”

Still, many analysts expressed surprise, both at the extent of deficits in the new Bush budget and its extensive use of Social Security money to cover them. What most surprised them:

- Far from running only a few years of deficits, the new budget assumes that the government’s so-called “on-budget” spending, which covers everything from maintaining a military to subsidizing Amtrak, will run \$150 billion or more in the red each year for the next decade, according to documents and White House officials.
- Instead of covering the bulk of the costs with expanding income tax revenue that can be expected with the resumption of economic growth, the plan relies heavily on Social Security money to nudge the overall budget—which includes on- and off-budget spending, such as payments to retirees—into the black by 2005.
- Although the president argues that the chief reason the nation must run in the red is to pursue the war on terror, his budget calls for new tax cuts—over and above the 10-year, \$1.3-trillion package approved last year—equal to or greater than the new defense spending he seeks. The plan includes \$590 billion in additional tax cuts over 10 years, but only \$550 billion in new defense spending.

“Everybody concedes that deficit spending, if it is in response to an emergency like Sept. 11, is not a bad thing,” said Robert Bixby, executive director of the anti-deficit Concord Coalition. “But what’s astounding is that this goes way beyond what was [once] a strong political consensus to save the Social Security surpluses.”

In fact, before the September attacks, the president was at the center of that consensus. In addressing a joint session of Congress only one year ago, he declared that “to make sure the retirement savings of America’s seniors are not diverted in any other program, my budget protects all . . . of the Social Security surplus for Social Security, and for Social Security alone.” His pledge was considered critical to winning congressional passage of his \$1.3-trillion tax cut.

But Bush and his aides appear to have decided that they cannot pursue their new military and homeland defense goals, protect the president’s already approved tax cuts and maintain the Social Security surplus. And they apparently think there is little political cost to giving up on the surplus pledge.

In part, that’s because there is no immediate danger to retirees’ checks. The system expects to collect more than \$700 billion in revenue this fiscal year and pay out only about \$470 billion in benefits. But analysts warn that failure to keep running surpluses and paying off Federal debt will leave the country in a painful bind as baby boomers retire in growing numbers, and will burden the smaller generation of workers that follows with rising Social Security tax costs.

“By paying down the debt, we were increasing national savings, reducing the upward pressure on mortgages and corporate debt, and cutting the government’s own interest bill,” Rubin said.

Analysts drew the analogy to a couple paying off their home mortgage before retiring in order to cut monthly costs and save. They said that Washington was mak-

ing the payoff in the nick of time because boomers are expected to begin leaving the work force in substantial numbers around the end of the decade.

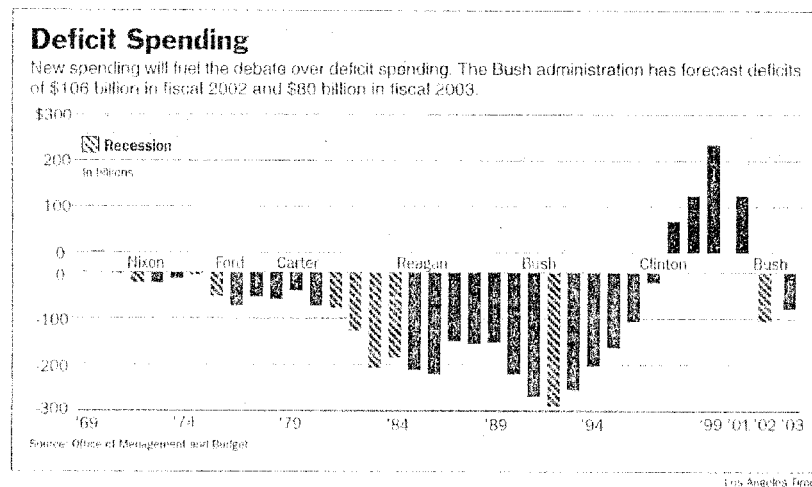
Rubin and other analysts said that the administration's sudden lurch into deficits demonstrates that last year's tax cuts were more than the country could afford, and that any further cuts would compound the problem. "They're unwise and unjustified," said Reischauer.

But it was unclear Monday whether congressional Democrats will find the political spine to oppose a president with sky-high public approval ratings in the midst of a war on terror.

Capitol Hill Democrats criticized Bush for submitting a budget that goes into deficit, but they offered no suggestions about how to bring it back into the black.

In fact, the lawmakers suggested they would support policies that would make the deficit even bigger: While supporting Bush's increases in defense and homeland security, Democrats opposed offsetting cuts in highway, environmental and other domestic programs. At the same time, Democrats insisted they would not seek a tax increase or rollback of last year's tax cut.

About all that congressional Democrats would offer were ideas for curbing future tax cuts. Senate Budget Committee Chairman Kent Conrad (D-N.D.) said that the Democrats' budget proposal may include a "trigger" that would turn off future cuts or spending increases if the tax revenue to pay for them do not materialize.



Mr. KLECZKA. Mr. Chairman, the other article I would like to put in the record is the L.A. article entitled, Don't Tap Into Social Security. And in this particular article they have a poll. There is an L.A. poll, and here is what the poll indicates: that in a Times survey fully four-fifths of Americans, including more than two-thirds of the Republicans—let me repeat that. The Times survey indicates fully four-fifths of Americans, including more than two-thirds of Republicans, say they would rather defer future tax cuts than use Social Security money that way. Thank you, Mr. Chairman.

[The article follows:]

TIMES POLL**Don't Tap Into Social Security****Nation: Four-fifths favor tax cut deferment over using the fund's revenue to pay for other programs.**

By RONALD BROWNSTEIN

Times Staff Writer

February 5 2002

WASHINGTON—Although Americans express resounding approval of President Bush's performance at home and abroad, an overwhelming majority would rather cancel later stages of his signature tax cut than tap Social Security revenue to pay for other government programs, a Los Angeles Times Poll has found.

With war, the recession and the tax cut's cost straining the government's bottom line, the White House on Monday released a budget that projects Washington will need to divert \$1.73 trillion in Social Security money to fund other programs through 2012. But in the Times survey, fully four-fifths of Americans—including more than two-thirds of Republicans—say they would rather defer tax cuts than use Social Security money that way.

Those findings may be the most ominous clouds for Bush in a political environment defined mostly by his extraordinarily broad support.

Congressional Democrats charge that Bush's tax cut, more than any other factor, obliterated the anticipated Federal budget surpluses and forced the government to dip deeply into Social Security revenue—barely more than a year after a 2000 campaign in which both parties pledged to set aside that money in a “lockbox” to reduce the national debt.

So far, the poll suggests, Democrats have not pinned the blame on Bush for the reversal: Substantially more Americans blame the terrorist attacks of Sept. 11 than the tax cut and Bush's policies for the return of federal deficits. And more Americans express faith in Bush than congressional Democrats to revive the economy.

But on a series of questions, a majority of Americans indicated an openness to reconsidering the tax cut—something Bush has pledged will happen only “over my dead body.” Said Doris Walls, a secretary in Denton, Md., who responded to the survey: “Absolutely do not use Social Security for anything other than Social Security. If they can't figure out some other way... don't go ahead [with the tax cut].”

The Times Poll, supervised by Polling Director Susan Pinkus, surveyed 1,545 adults from Jan. 31 to Feb. 3. It has a margin of sampling error of plus or minus 3 percentage points.

The survey, taken after Bush's State of the Union address Jan. 29, finds the president in a commanding position. Fully 80% of Americans say they approve of his job performance—down only slightly from his stratospheric 86% rating in November. (Even nearly two-thirds of Democrats give him positive marks.) Three-fourths say they approve of his handling of foreign policy; 83% endorse his performance on the war in Afghanistan.

Jan Kendall, a small-businessowner in Slidell, La., offered a typical assessment. “I don't think anyone could have done anything better on the war,” she said. “He held his cool when initially it would have been so easy to just start sending fliers over there.”

Another measure of the confidence in Bush as commander in chief: More than three-fourths of Americans said they would support military action against Iraq, which he named as part of an “axis of evil” that threatens other countries.

The backing Bush has generated through his performance in the crucible of war has spilled over to other issues, the survey found. By 42% to 30%, Americans expressed more confidence in Republicans than Democrats to handle the major problems facing the country. That advantage may reflect the sense that terrorism has become the nation's top priority. Asked directly which party they trust to fight terrorism, Americans picked the GOP by more than 3 to 1.

With his recent signing of landmark legislation reforming federal education programs, Bush has also erased the historic Democratic advantage on that critical domestic issue: More Americans express confidence in Bush (38%) than Democrats (30%) to improve the public schools. On health care—another issue that has long favored Democrats—Bush and congressional Republicans have fought the Democrats to a draw, the poll found.

The survey found substantial support for several other priorities Bush laid out in his State of the Union address. For instance, more than eight in 10 respondents said they support his call for spending \$38 billion on homeland security next year; a thin

majority said it would support the request even if it means cuts in other domestic programs.

Likewise, three-fourths of respondents endorsed his proposed \$48-billion increase in defense spending, and just over half said they would still support that added money even if it requires cuts in domestic programs. "That has to be our top priority because we have to build up our armed forces; we have to get our country safe," said Sharon McCann, a homemaker in Bird City, Kan.

On other fronts, two-thirds embraced Bush's proposal to build a national missile defense. And, though considerably more Americans expressed confidence in congressional Democrats than Bush to protect the environment, a narrow plurality sided with the president on the central environmental issue dividing the two parties: By 48% to 43%, Americans said they supported the administration's proposal to open part of the Arctic National Wildlife Refuge to energy exploration.

But on the economy, Social Security and the Federal budget, the poll finds more hesitation about Bush—and a few outright chinks in his formidable political armor. The country appears torn between its general confidence in Bush, its attraction to walling off Social Security money and its uncertainty about the economic value of the tax cut at the heart of the president's domestic agenda.

Approved last year, the tax cut totals \$1.3 trillion and is set to be phased in over 10 years.

The confidence in Bush is evident in the striking finding that two-thirds of Americans support his handling of the economy, even though four-fifths say the country is in recession. A third of Americans say they trust Bush most to revive the economy, compared with 29% who look toward congressional Democrats and 19% for congressional Republicans. Even if that's a much smaller advantage than Bush enjoys on security-related issues, rarely do voters express so much backing for a president's economic management when the economy is sputtering.

Yet these questions divide the country along partisan lines unlike anything relating to the war on terrorism. For instance, nearly three-fifths of Democrats picked congressional Democrats as best able to revive the economy, whereas over half of the Republicans picked Bush. Independents divided almost evenly between the two sides.

These partisan divisions resurface in other economic questions. Overall, the country appears ambivalent about whether Bush's policies will strengthen the economy: 38% said yes, 41% said they will make no difference and 16% said they will weaken it. The country also is divided about his tax cut, with 43% saying it's been good for the economy and 47% saying it's either been bad (29%) or had no effect (18%).

On both questions, Americans divided sharply along partisan and ideological lines. Conservatives such as McCann remain enthusiastic about keeping the tax cut law in place. "If you have tax cuts, the economy does better; when you raise taxes, the economy doesn't do well," she said.

But Gene Meyers, a retired architect and self-identified liberal in New York City, believes the tax cut has been a mistake. "I think it's insane," he said. "The president campaigned on a fiscally responsible [platform]. I cannot understand how you can be fiscally responsible and create deficits wantonly."

In the survey, many Americans shared Meyers' fear about deficits. Looking backward, Americans were not inclined to indict Bush for the return of the red ink: Just 11% blamed the tax cut and 13% Bush's policies, compared with 42% who blamed the terrorist attacks and 15% the recession.

But looking forward, the poll found enormous resistance across party lines to tapping Social Security money, or raising the national debt, to pay for other government programs, as the budget Bush released Monday proposes to do.

Asked whether future installments of the Bush tax cut scheduled for 2004 and 2006 should go through if that meant the government would have to use Social Security revenue to fund other programs, Americans said no by 81% to 13%. Even roughly seven in 10 Republicans and conservatives said they would shelve the tax cut under those circumstances.

Asked if the tax cut should go through if it meant tapping Social Security and increasing the national debt—as Bush's budget proposes for the next 3 years—84% said no. Looking toward the 2004 presidential election, 48% of registered voters said they are inclined to give Bush another term, whereas 30% said they would prefer a Democrat. But when asked which party they intend to support in this fall's congressional elections—47% picked the Democrats, 41% the GOP.

Chairman THOMAS. Thank the gentleman. The gentleman from Illinois wish to inquire?

Mr. WELLER. Thank you, Mr. Chairman. Mr. Secretary, now it is good afternoon; and thank you for coming before the Committee today.

I also want to commend you on your frankness and direct response to the questions being asked today.

The Bush Administration has got a big challenge. You are fighting a war against terrorism. You are working to make our homeland more secure here at home. You are also working to get the economy moving again. And President Bush's speech last week was right to the point. It is all about jobs. We want to win the war against terrorism. We have to get this economy moving again.

If you look at the history here, it is an established fact President Bush inherited a weakening economy when he came in. In January, his White House housewarming present was a weaker economy. He proposed the tax cut using 20 percent, 20 cents on the dollar, the surplus at that time, put some extra money in the pocket-books of folks back home. And economists tell us it was working. In August, the economy was beginning to grow again. Unfortunately, the tragedy of the terrorist attack not only cost thousands of lives, but it has hurt our economy. Since September 11th over a million Americans have lost their jobs as a result of the terrorist attack and the psychological blow to the confidence of investors and consumers. Of course, we have been working now to try and get it going again.

The President's budget that he has outlined this week works toward that goal, getting this economy moving again. Clearly, we have to win this war on terrorism. It is not going to begin and end in Afghanistan. It is going to take years. It is going to cost billions to make our local communities more secure. But we need to get this economy going again.

One of the concerns I have got is there are some on the other side of the aisle, Senator Kennedy, Senator Jeffords and others, and perhaps some in this room, who have advocated raising taxes. You say, and you made it very clear this morning, that delaying the President's tax cut as it is going to be phased in, lowering the rates for small businesses and entrepreneurs, eliminating the marriage tax penalty, eliminating the death tax, giving greater opportunity to save for retirement, to increase the child tax deduction, you stated that killing that phase-in is a tax increase. And from your standpoint, as someone who was in business for years, what—you know, this type of tax increase as proposed by Senator Kennedy and Senator Jeffords and others, how would that impact their economic recovery?

Mr. O'NEILL. It would slow down the track that we would otherwise follow. It would reduce the number of jobs in the economy, compared to where we would otherwise be, and it would be a substantial negative.

I think there really is a telling point, which I said earlier, that by the rules of the Congress, if—I can't believe this is possible, but if you were to decide to change the benefits that were flowing for child credits and marriage penalty and the other things that

seemed so wise last year, your own rules would show it as a tax increase.

So I think there is no doubt, both in substance and in fact and by scoring procedures, if you don't follow through on what you have already voted you are really voting for a tax increase. I think there is no doubt in the economic observation that as government takes more it reduces the economic potential of a society.

Mr. WELLER. You know, Mr. Secretary, I have heard not one word from a real-world economist saying we should increase taxes during a recession. Many economists also told me that small business people, investors and consumers, their confidence is based on continuity, and they are already making decisions today based on those changes in tax law. And if we were to change that tax law as they are basing their decisions upon it, it could jeopardize economic growth.

So I appreciate—like you used to say, if it walks like a duck, quacks like a duck, it is a duck. In this case, if it is a tax increase, it is a tax increase; and that is what Senator Kennedy and Senator Jeffords and others have proposed.

Chairman THOMAS. The gentleman from Georgia wish to inquire?

Mr. LEWIS OF GEORGIA. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being here.

Mr. Secretary, I want you to tell us what does this budget do to preserve Social Security and what does the budget do to strengthen Medicare?

In addition, I want you to tell us how much does the budget take from Social Security, how much does the budget take from Medicare?

Mr. O'NEILL. Well, this budget fully funds the obligations that the Federal Government has to—under current law to Social Security and Medicare beneficiaries. It takes nothing away. In fact, the President has proposed that we make some modifications in benefits going forward for the Medicaid—for the Medicare population in the form of assistance with drug costs. So I think it is a very fulsome budget in meeting our responsibilities.

Mr. LEWIS OF GEORGIA. Mr. Secretary, could you tell me how much you will be borrowing from future retirees? It is my understanding over a period of 10 years we would be taking \$1.4 trillion from Social Security, \$550 billion from Medicare. Am I right?

Mr. O'NEILL. No, you are wrong.

Mr. LEWIS OF GEORGIA. Tell me.

Mr. O'NEILL. We are going to take all the Social Security and Medicare money, and we are going to credit it to the Social Security trust fund. Now, from a cash flow point of view, once it is credited to those accounts where it belongs, from a financial accounting point of view—if you are saying to me, let's take that money then and use it to buy down the debt, we could do that. And then we will go out to the public, and we will borrow money to meet all of the cash flow obligations.

It seems to me, you know, if this is really a serious conversation that we have been hearing this morning, we would solve all of this illusion that we are borrowing money from Social Security or Medicare by simply using all of that money to go ahead and buy down debt held by the public, and the next day we could borrow the

money that is necessary to meet the cash obligations of the Federal Government, which we only do in response to laws passed by the Congress.

We are just doing—we are executing the laws passed by the Congress. It really doesn't seem particularly enlightening to me for people out there in America to believe from this conversation that we in the Administration or you in the Congress would really seek to damage them by not having the money to meet our obligations to Social Security recipients and Medicare recipients going forward. I think nothing could be further from the truth.

Mr. LEWIS OF GEORGIA. When you do propose paying the credits back, would the funds be there when the baby boomers come of age?

Mr. O'NEILL. Well, again, I would say, as I did before, if implicit in this question is it a good idea to put the unfunded liability of all of our trust funds on a balance sheet and begin using that as a discipline for how we do business here in Washington, I would sign up in a moment. I don't find many Members who want to do that.

Mr. LEWIS OF GEORGIA. Mr. Secretary, let me move to another area. I am deeply concerned about the Enron situation, not just for the thousand Enron employees, but in my home State of Georgia, the Georgia State employees and teacher retirement system lost more than \$125 million. Is there anything in the budget—are you proposing anything to help these people?

Mr. O'NEILL. Help me a little bit. These are people who are employed by Enron?

Mr. LEWIS OF GEORGIA. No, these are people that invested their retirement fund in Enron stock, and they lost more than \$125 million.

Mr. O'NEILL. The American people should pay for that?

Mr. LEWIS OF GEORGIA. No, I am asking.

Mr. O'NEILL. We have not proposed that the American people should pay off those people who lose money in any stock.

Mr. LEWIS OF GEORGIA. This is their pension. This is their retirement. We bail out the airlines. We help the major airlines. Can we help the people who lost hundreds, thousands and millions of dollars—in the case of Georgia, \$125 million?

Mr. O'NEILL. The Congress passed—for the airlines, the Congress passed an emergency—a \$5 billion cash flow assistance bill—it was agreed among all the Members and the Administration—and a \$10 billion provisional loan guaranty program. I think that is true.

But I don't see the parallel between that where, in effect, the Federal Government shut down, appropriately so, all of the air travel for a period of time and because of the terrorist attacks, which was an attack on all the American people, I think you acted in a wise way to make sure that the airline industry did not go into complete liquidation. I think that was a wise thing.

The general import of your other question is that somehow we should save the American taxpayers—if individuals make investments in individual companies and it doesn't turn out well that the American taxpayer should make up that difference. I don't find that is a very good idea.

Mr. LEWIS OF GEORGIA. Maybe not on your watch. But some time ago, Mr. Secretary, we bailed out the S&Ls and why not bail out the retirees? They only depend on Social Security. I guess that would be the only thing left. But if we steal from Social Security and leave all of this red ink, there won't be much of anything left for anyone.

Chairman THOMAS. The gentleman's time has expired. The gentleman from Tennessee wish to inquire?

Mr. TANNER. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary.

I do not have a chart. I think the conversation this morning has been enlightening in that probably charts should be—that are 10 years in nature should be taken with a grain of salt. Both of us know that the charts we had last year showing what was going to happen over the next 10 years are totally in error. I would suggest that most of the charts we have seen this morning about what is going to happen in the next 10 years are probably in error.

Let me tell you what bothers me about the budget. It is the obligation on the next generation. We have had a lot of talk about what is Social Security borrowing and so forth. I agree. It really doesn't matter if one begins to talk about the debt of the country and the debt of the individual citizens who live here.

As you know, the Blue Dogs talked about that last year. We said, wait a minute. We ought not to go into a 10-year projection and use up most, if not all of it, based on what we think is going to happen. We couldn't foresee the war. We couldn't foresee a natural disaster. We couldn't foresee a lot of things. We can't this year, over the next 10.

We are not reducing the Nation's debt like we thought we were going to. I think you will agree with that statement. Our financial condition as a nation has deteriorated from the time you were here last year till today in a rather major way, given 10-year projections as the measure of that financial condition. Would you not agree that we have deteriorated in that regard?

Mr. O'NEILL. We have had some change, but it is very interesting to see where we are going. I showed you earlier the chart that I think represents a real truth that we are going to have a huge increase in revenue at the Federal level over the next 10 years without fail. I think there is no doubt about that. And it is also true that government debt burden is going to fall as interest costs are a smaller and smaller fraction of Federal spending in total. So I think we are going back—by our light, we are going back on a track of debt reduction as we go through this 10-year period.

So while there is some delay in how fast we are going to buy back the debt, it is still our intent with our program and the tax regime to reduce the outstanding debt held by the public.

Mr. TANNER. Well, Mr. Secretary, that is nice to know. But I know this: Common sense tells me that we are borrowing money and paying interest on that money every year, that we are not retiring the debt like we thought we were, and just from that standpoint common sense tells me our condition is worse, not better than it was last year.

Now you can talk about how you parse that out, but I also know that you are right when you say restoring growth in the economy

is a key to getting out of this. I know that as the government borrows money it puts upward pressure on interest rates. And as interest rates rise, then the money available in the private sector to create jobs may not be as fluid as thought.

So all I am saying is I don't think this budget that you have presented has enough correlation between income, outgo and debt retirement. Because over the next 10 years you do not foresee in this budget an on-budget surplus, that is, monies available to pay down debt for the future generations that don't come from the social insurance tax or some other. I think that is a shortcoming of this budget, and I hope you will look at it.

I would say this: When people say that if one suggests that any part of the tax cut that is to be phased in over the next 10 years by deferring it is raising taxes, then it seems to me that we raise taxes in 2011 when we passed it, in a way probably the most major increase in American history.

All I am saying is, as Mr. Greenspan said, when we look at the next 9 years—and you will be back next year, I hope, and I hope we are all here—I hope you will figure out a way to present a budget that gets us into a surplus situation in the on-budget area before another 9 years goes by. I don't think that is the best we can do. Thank you.

Chairman THOMAS. Thank the gentleman. The gentleman from Missouri, Mr. Hulshof, wish to inquire?

Mr. HULSHOF. I do. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

I think some of the questioning, not of the last questioner, my friend from Tennessee, but I think some of the questioning of you this morning has been a bit unfair. They have taken statements that you made before September the 11th and previous appearances here and then comparing where we are today as a nation with our economy and saying with righteous indignation which I think has been misplaced, in the words of one of my colleagues, what a shocking change.

Well, our Nation has experienced a shocking change. None of us could have anticipated the terrorist attacks or the recession or homeland security, the round-the-clock rebuilding and recovery effort. So I think comparing statements that you may have made to us a year ago to today I think is a little bit unfair to you. I do want to thank you for your strong support of what this Committee has put forward in the short-term economic stimulus bill.

I think it is interesting to point out that in December 1999, speaking of statements, some time ago, in a speech that then Governor Bush made to the greater Des Moines Iowa Chamber of Commerce, he said this: I also believe in tax cuts for another practical reason, because they provide insurance against economic recession. Sometimes the economists are wrong, then Governor Bush said. I can remember recoveries that were supposed to end but didn't and recessions that weren't supposed to happen but did. I hope for continued growth, but it is not guaranteed. A recession would doom our balanced budget. But if delayed until a downturn begins, tax cuts would come too late to prevent a recession. Putting more wealth in the hands of the earners and creators of wealth now be-

fore trouble comes would give our current expansion a timely second wind. End quote.

Again, this was in December 1999. So I applaud your endorsement of what we have tried to do in the short term as far as economic stimulus. I agree that a stimulus is still necessary, as you have stated in your testimony, to hasten and to strengthen our recovery.

What I want to do, though, in the last minute or so that I have, is move away from the short-term stimulus to long-term certainty. As you pointed out and as my colleague in the State of Washington questioned you earlier, the President last Tuesday in the State of the Union stated, for the sake of long-term growth and to help Americans plan for the future, let's make those tax cuts permanent, end quote.

Now, my colleague, Paul Ryan, who is where he needs to be right now with his wife and newborn daughter, he and I have cosponsored H.R. 2316 that would sunset the sunset, that is, to make the tax cuts permanent. I think probably most Americans may not realize as they are perusing their 1040s now that the increased child tax credit or the phaseout of the marriage penalty or certainly the phaseout of the Federal death tax, that those are temporary in nature because of that arcane technical budget rule that put the sunset on an agriculture tax cut.

I would say, to make the record complete, that when Mr. Stark was inquiring and talked about a CBO budget estimate, the joint tax told us last November if we had made the tax cuts permanent in the last fiscal year it would have been a cost to the government of \$112 billion.

Now we are now in a new fiscal year. I know that for those that live or die by these estimates—I acknowledge what Mr. Tanner said—these estimates we know are going to be wrong, but that is not the sum of money that—I think there is some fault and assumptions that the Congressional Budget Office has made as far as their claim that this would be a \$627 billion hit. But putting the numbers aside, I think from a public policy point of view that this is the right thing to do.

You talked about the positive economic implications of making the tax cut permanent. What I hope we don't get into is kicking along these extenders as we do with research and development or work opportunity tax credit or welfare to work tax credit. Can you envision a situation where we were to continue to phase out the death tax maybe in 2-year increments or 4-year increments? Would that satisfy the certainty, Mr. Secretary?

Mr. O'NEILL. No, I think permanent is really permanent. And I suppose it is—maybe it is too much to hope for, but it would be great if we could get to a position where—maybe we could create another device to show that people care by voting, that they care about these things, instead of actually leaving the cliff-hanging uncertainty of whether or not the Congress is going to come through with things that everyone seems to agree with are necessary and desirable to do.

Mr. HULSHOF. As my final comment I would echo what Mr. Tanner said, again, my friend from Tennessee, on December 31st of 2010: We will have lower tax rates. And if Congress does nothing,

the lower 10 percent tax bracket will go up to 15 percent, the lower 35—the 35 percent tax rate will go up, again, close to 40 percent.

Putting aside whether a suspension of the current tax cuts is a tax increase or not, certainly if Congress fails to act would you agree with me that on January 1, 2011 we are going to see significant tax increases if Congress fails to act?

Mr. O'NEILL. Absolutely.

Mr. HULSHOF. Thank you. No further questions, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The gentleman from California, Mr. Becerra, wish to inquire?

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. Secretary, thank you very much for being here and your patience as we go through all these questions.

I think over the next year we are all trying to figure out how we get through this debacle that we see economically. No one could have expected the recession to hit as quickly as it did last year. Certainly no one expected 9/11. But now that we confront it, we have to deal with it.

I appreciate the remarks that you have made and the President's State of the Union address. Clearly, it is going to be a choice of a balance of priorities, where we choose. I don't think there is any question that the President outlined the need for more homeland security, the need to be able to defend against terrorism. So as we weigh the balance—weigh the competing interests and engage in that balancing act, I think a lot of us are asking ourselves, what are the President's real priorities?

We understand that he has indicated an interest in increasing homeland security, and I don't think anyone will question the need for that. Whether you weigh that against Social Security or education or tax cuts, I think all of us are prepared to do what is necessary when it comes to homeland security.

When it comes to the war on terrorism, I believe the President himself said it probably is costing us a billion dollars a month. So that is about \$12 billion a year. If you were to extend that for 10 years, and God forbid that for the next 10 years we are under the same scenario, that would be \$120 billion over the next 10 years to deal with terrorism.

When I look at the President's budget on education, I start to have some concerns. Because while I agree that we need to do what we can on homeland security and while I agree that we have to deal with terrorism, if you assume it is \$120 billion over the next 10 years, and, as I said, God forbid it is, none of those priorities will eat up the Social Security trust fund or the Medicare trust fund. But, yet, the President's budget takes at the end of 10 years close to \$2 trillion out of those trust funds that are meant for retirement and medical services to the elderly.

Then when you look at the President's budget, while he increases spending on defense, which in some cases I believe is very necessary, he cuts programs like summer job programs. He eliminates them. He eliminates the program to reduce class size throughout the Nation, completely eliminates the funding for it. He eliminates all funding for school construction.

I must tell you in Los Angeles, where I live, in my district we are having to build more than 60 schools in the next 5 years just

to meet the rate of growth. We are not talking about even reducing the size of the classroom.

So it concerns me greatly when we see so much money going out and we see that the tax cut that we passed last year—I did not vote for it but that passed last year and that the President is proposing would now eat into it even worse.

To me, for us to have a year ago voted and for the Administration to have talked about a lockbox for Social Security, to say we are going to keep that money locked away, none of us will touch it, we will keep our greedy fingers off of it, all of a sudden we find that vote was—I remember going back home. Many people said it would be it was worthless. That lockbox has been blown apart by this budget.

I don't see how we can justify to the American people doing differently than what they themselves must do. We all go into deficit spending. I think we all understand that. When we buy a home, we don't pay the money up front for that home. We take out a mortgage. That is deficit spending. But we know it is for a good reason, so over the next 20 or 30 years that we are going into deficit spending on that mortgage. When we provide for our kids' college education, we go into deficit spending because we know there is a good at the end of that when our child receives that degree.

I don't see how we believe that in providing tax cuts that will benefit megacorporations or the wealthiest of Americans—because the estate tax cut repeal, for example, which would benefit only the 2 percent richest Americans, American families, certainly does nothing to help the 98 percent of other Americans—that we can justify that balancing act and talking about tax cuts versus Social Security or tax cuts versus education or tax cuts versus homeland security.

Mr. BECERRA. If I am going to spend money and save some money, and certainly I hope we will, I would hope that the President would come back to us and say, "These are my priorities."

What I see right now as the President's priority is tax cuts above Social Security, tax cuts above prescription drugs for seniors, tax cuts above some review programs for low-income children who otherwise spend their days on the street corners, and tax cuts above even something as important as special education, which for years the Federal Government has refused to fund at the level it had committed to more than 15 years ago. We committed as a government to fund 40 percent of all the costs of special education. We only do about 10 to 12 percent.

So I hope, Mr. Secretary, that you will go back and talk to the President about what our priorities are and we will come back in a bipartisan fashion and do something for the American people.

Thank you, Mr. Chairman.

Mr. O'NEILL. Mr. Chairman, may I just say a couple of things on these comments?

First of all, I hope I made it really clear that we do not think we should raise taxes in this slow economic period. And then your question about priorities, maybe you don't join me, maybe you think we should raise taxes—

Mr. BECERRA. Mr. Secretary, I never said we should raise taxes.

Mr. O'NEILL. You join us in not wanting to raise taxes. Then I would ask how would you rearrange, given what the President has said—and we have to prosecute the war on terrorism, we have to deal with homeland security, and then you mentioned education several times.

Let me tell you the numbers for education. In 1996, discretionary spending for the Department of Education was \$23 billion. The President's proposal for 2003 is \$50,310,000,000. If that is not an expression of priority—and maybe you are saying, well, it was all done before, the number in 2000 or fiscal year 2001 was \$40 billion, I think it speaks to the issue of whether or not the President cares about education; he cares about it, he puts his money where his mouth is, and he has not reduced it. He has increased hugely education-proposed spending. He led the charge that gave us the hope of fulfillment of “no child left behind.”

So I don't think it is true. No one should believe that this President has chosen prosecuting the war on terrorism over the importance of educating children. That is simply not true.

Mr. BECERRA. Mr. Secretary, he has proposed to eliminate rural education programs, drug prevention programs, reduce drug-free school programs. We can use those programs in our districts, Mr. Secretary.

Chairman THOMAS. The gentleman's time has expired.

Mr. O'NEILL. Just one more comment. This President has made deliberate decisions about programs that either have not worked or which can be funded under these broader education authorities that give more discretion to the local recipients instead of earmarks from here in Washington.

Mr. BECERRA. Dropout prevention programs should be eliminated?

Chairman THOMAS. The gentleman's time has expired. The gentlewoman from Florida?

Mrs. THURMAN. Mr. Secretary, I, like everybody else, thank you for being here today, but I do kind of want to answer what you just said about priorities.

Remembering in 1996, and when you recognized the \$24 billion that was suggested for education as to now, that was a Republican Congress. There were a lot of us fighting for additional dollars for education, but we at that time were also concerned about deficits and deficit spending, and we were trying to put ourselves on an economic track.

In fact, in 1997, this Committee voted for a balanced budget amendment or a balanced budget, and in fact where we did tax cuts, where we did what we thought was proper for getting this economy going. So I don't think you can just say, you know, all of a sudden accept the fact that now all of a sudden everybody believes we can just jump it up to \$40 billion and not worry about what is happening with the deficit.

I would also say to some that have left now, let me just say, when we talk about Kennedy, when we talk about Jeb Bush in Florida, he is under a constitutional amendment on a balanced budget. Does he not have the same concerns as homeland security? Are we not asking our law enforcement at the State and local lev-

els to worry about that as well? Do you not believe that his educational priorities are not the same?

We all believe in these priorities. We believe in the Medicaid system at our State level. But they are in a different situation because they have a balanced budget. They had to delay their tax cut. They are now in session having to overhaul their whole tax system, about which, by the way, there is a lot of concern of what is going on.

So I think when you start listing people and who raises taxes and who does this, isn't it more important that the debate should be about the balance of what we are doing for this country; that we are looking at all of the issues that are of a concern, not pointing fingers, where if you say this you are raising taxes, if you say that you are balancing the budget? I just think that is hogwash.

I will tell you, Mr. Secretary, and the rest of the folks here, I was in the drugstore the other day talking to my pharmacist, picking up my medicine for my husband, who has a kidney transplant, as many of you know, and it was \$1,500. Thank God we have health insurance. And the pharmacist said to me, well, Karen, what is going to happen with the prescription drug plan? I said, I think we might have a card, it might give 10 percent. He said, you know, Karen, quite frankly, we already have that. We have the People's Plan, we have this plan. It might save a little here, might save a little there.

He said, "Well, what else?" I said, well, I think that all of us stood very strongly with the President on the idea of what was going on with the war. All of us came in here with the idea that we needed to stand shoulder to shoulder with him. We looked at the \$40 billion, we looked at the bailout, we did those kinds of things.

But I said, "You know, Billy, I am really kind of concerned where we are going now with the deficit." He said, "Let me tell you about this conversation that was taking place." And if you can imagine walking in to the pharmacist, and what happens when you go into the drugstore, especially when you live in a small town, everybody knows everybody.

This guy looked at him and he said "You know, I listened to the President the other day. If I had wanted a loan for myself, I would have gone to the bank and gotten it." That is what they feel like is happening, we are taking a loan out, that we are taking a loan out that some people did not necessarily want; you know, that they think that now they can pass that on to their children or their grandchildren to pay that loan back.

Quite frankly, these were the same people that came to me when I ran in 1993 and said, Mrs. Thurman, please do something about the deficit. Please do not put us in that situation. They talked about Social Security and they talked about those things.

So let me just say that I think that one of the other things that we have to say when we talk about not scaring the American people, and I agree, but one of the things that we do not talk about is what will go on when we have not asked the question: How far out do we see Medicare now? How far out do we see Social Security? We know those dates were extended the last couple of years to '36 or '37. At 2025 they start to fall back in. We can say that.

But I think what people are feeling, and I would agree with Mr. Becerra on what is happening at home, you know, what are we doing? We take a credit and put it in there. If I do that and then I write a check, I get an overdraft. The overdraft I get I have to pay a penalty on. That is kind of what we are doing with this now.

So I do not want to get into all of this, but please, let us forget all of this stuff about who is raising taxes, who is not raising taxes. That is not what this debate is about. There is a fundamental philosophical difference in what we believe should be a balanced approach and one that keeps us on the right track for financial security for this country.

Chairman THOMAS. I thank the gentlewoman. Does the gentleman from Kentucky, Mr. Lewis, wish to inquire?

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman. Mr. Secretary, thank you for being here today.

One of my concerns about this hearing today is that I have parents that are 85 years old, and if they are watching today, I think there would be a certain amount of concern for them, because my friends on the other side of the aisle seem to want to put fear in their hearts that Social Security is not safe; that sometime in the future it is not going to be there because of tax relief for other people in this country. And they also got some tax relief.

My son and my daughter-in-law, they work in a factory. Both of them together make about \$60,000 a year. They need tax relief. Forty percent of their income is in local, State, and Federal taxes, so they have a major tax burden. And if you add in regulatory costs, it is probably about 50 percent of their income. They need help. They work weekends to try to make ends meet, and overtime.

To try to bring into the debate in this country about how we should use our national resources, to try to instill generational envy, and to put fear in the hearts of senior citizens I think is a sad thing, but that is what we keep hearing.

I do not think there is anyone who is probably here today, Republican or Democrat or whatever, that does not have family members that are on Social Security, that does not have family members that could use some tax relief. So I think it is a sad state of affairs when the once-proud Democrat Party now is relegated to the point of where the only thing they have to offer is fear and class envy, and they have no solutions.

If you ask them, well, are you for tax increases? No, we cannot do that. Are you for cutting spending? Well, we need more spending in this, we need more spending in that. What answers do they have? I would have hoped that today, when we have hearings like this and hearings in the future, that they could bring something to the table besides fear and envy. That is not what this country is all about.

When that is all they have to offer, you know—my mom and dad basically have been Democrats all their lives until just here recently, and I think they feel pretty sad about where that party has come to.

Mr. HULSHOF. Would the gentleman yield?

Mr. LEWIS OF KENTUCKY. Yes, I will be happy to yield.

Mr. HULSHOF. I appreciate the gentleman from Kentucky. I know my friend from Florida is still here in the room. But a comment

that I would like to make as far as she was talking about real life examples about where we are, I would share this with her and Members of the Committee.

My wife and I make our home in Columbia, Missouri. Back in 1999, the foundation of our house caved in. This was an emergency, it was unforeseen, so we had some choices to make around our kitchen table and the family budget. The choice we made was that we should go into debt for a short period of time. So we obtained a home equity loan because, again, this was an emergency, an unforeseen event.

I think that is where we are right now with our national economy. The gentlewoman talked about priorities, and I agree with her general statements. But for what happened on September 11, I believe we would still be in a surplus. I think that the President's budget would be in balance but for the increased requirements of the war on terrorism and homeland defense.

I see my friend from Dakota shaking his head. But in reasonable lines of disagreement, I would say this is a singular unforeseen situation that now confronts us. I bring our family example just to illustrate that fact. I appreciate the gentleman yielding.

Mr. LEWIS OF KENTUCKY. I just want this question answered directly, and I think you have done a good job of it. The Social Security Trust Fund is going to pay the Social Security benefits to my mom and my dad and to all the millions of senior citizens out there. They do not have to worry about it. They do not have to be fearful. If they were able to come to that fearful conclusion today that that might be the case, tell them right now, straighten the record, that is not the case; their benefits are solid, they are going to be paid for.

Mr. O'NEILL. Nothing could be clearer. The Congress of the United States and the President are never going to fail the obligation they have to the people to pay Social Security benefits as and when they are due.

Mr. LEWIS OF KENTUCKY. Thank you.

Chairman THOMAS. Does the gentleman from Texas wish to inquire?

Mr. DOGGETT. Mr. Chairman, thank you. Mr. Secretary, though we have very different perspectives on public policy, I sincerely thank you for your service to our country in these very troubling times.

Mr. O'NEILL. Thank you.

Mr. DOGGETT. Mr. Secretary, the year 2001 will certainly go down as an historically bad year for Enron in Houston, but here in Washington, on tax policy, it seems to me it was a rather good year. Enron successfully sought favorable treatment in that collection of subsidies and preferences that was called an energy bill; Enron successfully supported efforts to block an international crackdown on offshore tax havens; Enron's accounting firm Arthur Andersen was successful in opposing any legislation on abusive corporate tax shelters; Enron successfully led the AMT coalition, as we discussed, in obtaining House approval of repeal of the AMT; and instead of contributing something to the cost of the war on terrorism, to actually asking for a check for \$254 million back.

Can you tell the American people today of any tax break that Enron requested in the last year that this Administration did not embrace?

Mr. O'NEILL. I am stunned by the question, because I have no idea of what Enron was for with regard to taxes. I have no idea what they were for.

I think what was passed last year was the tax proposal recommended by the President, which the Congress responded to in quite a complete way, which was for the benefit of individual taxpayers.

Mr. DOGGETT. Let me ask you, then, about comments that you made last year. Last May, you indicated that you absolutely supported the abolition of all corporate income taxes and capital gains taxes on business in your interview in London. You called the present corporate tax system an abomination.

Mr. O'NEILL. I did.

Mr. DOGGETT. And you said, "Not only am I committed to working on this issue, but the President is also intrigued about the possibility of fixing this mess," and it was reported that you said that even though "abolishing corporate taxation would lead to higher personal income taxes," you thought repeal would be good for the country.

We now know that Enron used 881 subsidiaries, at last count, located in tax havens, and other devices that led it to pay modest or no Federal income taxation for the last several years. A number of other Fortune 500 corporations have also paid little or nothing toward our national security in recent years.

Is this a sign of healthy progress toward the goal that you advocated of "no corporate taxation," or is it an indication that the Treasury Department does not share former Secretary Summers' view that abusive corporate tax shelters are the leading tax compliance problem in the country today?

Mr. O'NEILL. Well, you have mentioned a whole lot of attributed things to me.

Let me make the record clear, because I have said this over and over again: I think the Federal Government's tax system is an abomination, and when I go out and talk to people around this country I do not find anyone who disagrees with me. If you can find someone who thinks what has been crafted here in Washington is a wonderful tax system that should be a model for the rest of the world, I wish you would send them to me so they could convince me that I do not know what I am talking about.

But as one who has lived under this tax system, with its increasing complexity, and paid taxes every year myself in substantial amounts since 1950, I can tell you it is an abomination. Maybe some are proud of it, but I do not think we should be too proud of it. It needs to be fixed.

And then, more directly to your question, am I in favor of an inequitable, unfair tax treatment for people in this country, absolutely not. Am I for people with higher incomes paying higher taxes? You bet. I don't know what other principles you would like for me to say. Have no doubt, I think I am on the right side of the angels in understanding what is wrong with this tax system and

the need for us to work together to make it something Americans can be proud of.

I think one of the great dangers we have in this country is that this tax system has become so complicated that even fair-minded Americans can make the case that it is too complicated for them to understand and respond to, and that is dangerous to our democracy.

Mr. DOGGETT. Finally, Mr. Secretary, last year at the Senate Finance Committee you said, "I believe that our tax system should be structured so that growth rates of zero or 1 percent . . . we are in balance."

Mr. O'NEILL. I agree with that.

Mr. DOGGETT. "That is to say that the tax system produces enough revenue under conditions of low or no growth that we are not borrowing from our children, that we are paying on a current basis for the things we have said are an appropriate object of public spending."

And you told this Committee, Mr. Levin in specific, that the deficits of the Reagan-Bush years "put ourselves in a ditch that was horrendous." What you said then I believe applies today, to show the folly of this borrow and spend budget proposal that will wreck Social Security and cut Social Security benefits in the future.

Thank you so much.

Mr. O'NEILL. I think with a combination of a war and a recessionary period, if there was ever a reason why we should be very marginally a negative, those are the reasons why we should do it. The President has said over and over again if not for the war, if not for the effect of terrorism, if not for the slow economy, we would be in balance and we would be in substantial surplus in fact.

I think, again, at zero rates of growth, which is about where we are, we have a very small negative number. And if someone believes we should raise taxes, they ought to say so, instead of having this deficit. If somebody believes we should not spend money to provide funds for our troops in Afghanistan, they should say so. If someone wants to cut education funding, they ought to say so.

The President has weighed all these things, and his judgment is in the books that we have sent to you.

Mr. DOGGETT. I am just saying the same thing you said last year. Thank you.

Chairman THOMAS. The gentleman's time has expired. The gentleman from By Gosh, North Dakota.

Mr. POMEROY. North By Gosh, Dakota.

Chairman THOMAS. Excuse me, North By Gosh, Dakota.

Mr. POMEROY. Mr. Secretary, thank you for being with us today. During your long distinguished private sector career, you have made reports to many boards of directors regarding the financial condition of the company. I doubt you have ever reported a reversal in financial position as dramatic as what you are reporting to us today.

Mr. O'NEILL. I never ever had an occasion to restate earnings, ever.

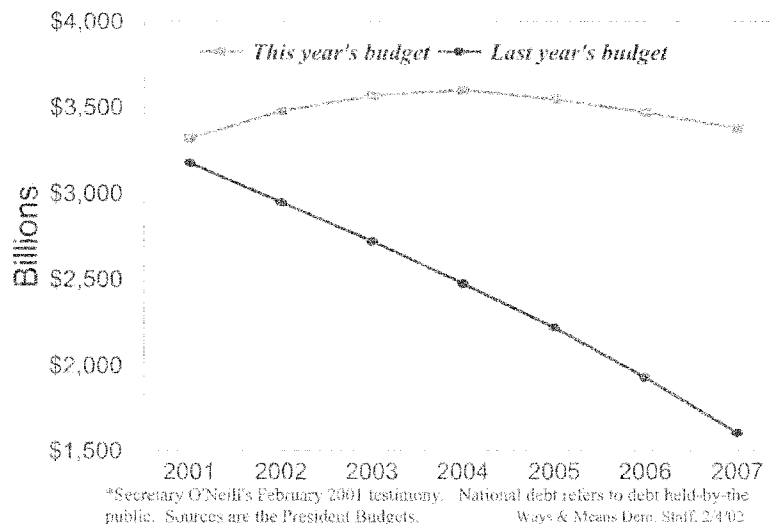
Mr. POMEROY. That is wonderful, although what you are stating to us today is a \$4 trillion picture to the negative different than what it was 1 year ago with very troubling conditions.

I would like a chart to reflect what it means in terms of our ability to retire national debt. Based on your numbers, Mr. Secretary, 1 year ago we were projecting a virtual elimination of the national debt by the year 2008. This year's numbers, shown in red, show virtually no elimination of national debt. It continues at the existing high levels for the foreseeable future. The reason for failure to pay down debt is because when the cash comes in on Social Security, we give Social Security an IOU and we spend the cash on running the government.

Mr. Secretary, do you believe that it will be easier for the Federal Government of the United States to meet its commitment to Social Security if the Federal debt held by the public is at a lower level rather than a higher level?

[The chart follows:]

What Happened to "Heading toward elimination of the national debt"*?



Mr. O'NEILL. I don't think the two are tied together in the way that you have suggested. I have said over and over again that I think that without a doubt none of you and none of your successors are ever going to fail the obligation made to Social Security recipients to deliver the benefits you promised. You are not ever going to do that.

Mr. POMEROY. I would like to pursue that. I do not mean to interrupt, but our time is short.

Next decade, we will run into a situation where in order to continue to meet the full obligations of Social Security we will have

to be redeeming some of the bonds held by the Federal Treasury. It will not be funded just on cashflow coming in from the payroll taxes. Is that correct?

Mr. O'NEILL. We are going to have to have the funds to pay our obligations. I'm sure we will have.

Mr. POMEROY. Basically, Social Security moves into deficit next decade, is that correct?

Mr. O'NEILL. The annual income from the then-working work force will be lower than the obligation requirements. Therefore—

Mr. POMEROY. Therefore, Mr. Secretary, in order to keep those obligations absolutely current, as you have committed to again today, we are going to have to take funds from the General Fund budget in order to make up for us not coming in with Social Security?

Mr. O'NEILL. That is not necessarily so. It depends on what action the Congress and the Administration might take going forward to amend and reform Social Security so that—

Mr. POMEROY. Are you suggesting that in order to bring these payments into line we might actually need to reduce benefits because the cash will not be sufficient?

Mr. O'NEILL. I would not suggest that. I am not ready to believe that—

Mr. POMEROY. Mr. Secretary, what other changes could we make that would, by the middle of next decade, bring this into balance, what is coming in on the payroll tax and what is—

Mr. O'NEILL. I think, as you observed, and we have had endless conversations about this this morning, in 1 year's time there has been a substantial change. That does not mean that the facts are going to be different, it just means that the estimates are going to be different.

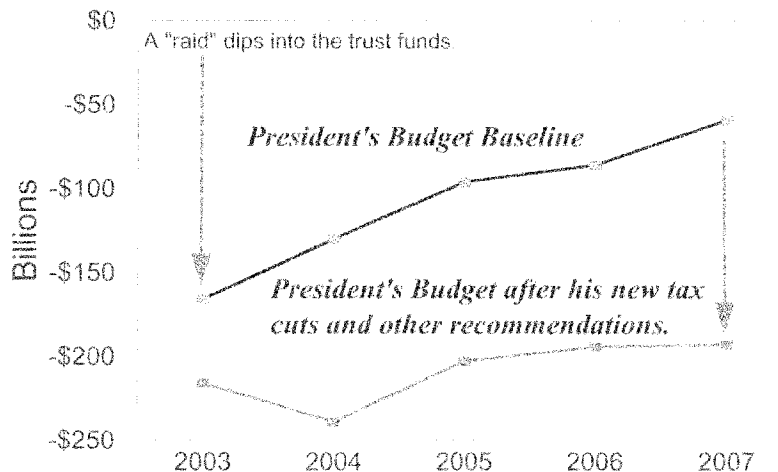
I would submit to you that there is a \$660 billion so-called technical change in the estimates. I do not know that it is not possible that next year we will have a \$660 billion technical correction to go the other way. I mean—

Mr. POMEROY. Mr. Secretary, I have another chart for you that shows that while we are already running in deficit position, passing the \$600 billion making the tax cuts permanent also proposed by the President takes us from a bad situation into a worse situation.

If you want to get out of a hole, it seems to me the first thing you stop doing is you stop digging. It appears to me the Administration would take us into even deeper deficit positions, taking us even deeper into debt and making it even more unlikely we will be able to meet the Social Security responsibilities.

[The chart follows:]

Starting with Raids on the Trust Funds The New Budget Makes Them Bigger



Trust funds refer to Social Security and Medicare-Hospital Insurance. Ways & Means Dem. Staff, 2/3/02

Mr. O'NEILL. I think it is just—I just have to tell you, I think it is really bad public policy to put up there starting with “raids,” when I think you would stipulate in private there is no such thing as a raid because the trust funds are intact; they are crafted with all the money that is collected from all the people, no matter what. No one is raiding the trust funds.

I would associate with the comment that said we should stop using language that incorrectly describes our fiscal situation because it is misleading the people who do not understand enough about public policy to know that certain assertions are wrong. It only scares them.

Mr. POMEROY. Mr. Secretary, I will conclude. Thank you for responding to my questions.

I would observe in conclusion, to the extent that Social Security proceeds, cash coming in on Social Security taxes, are used to fund the functions of government, used for the operating costs of government, you have made meeting the Social Security obligation you have spoken so forcefully of much more difficult going forward.

Mr. O'NEILL. If you don't mind me saying so, the important public policy question is, as we have maturing Social Security obligations, do we have the balance sheet at the Federal level to support them, and I would say to you without any fear of contradiction our

balance sheet will support the obligations we have made to the American people, without a doubt.

Mr. POMEROY. It seems to me we have viewed the surplus as people's money, but the debt as our children's obligation. I think that is unfortunate.

Thank you, Mr. Chairman.

Chairman THOMAS. Could I ask the gentleman, once again in terms of his charts, are the dollar projections adjusted for inflation or are they nominal dollars?

Mr. POMEROY. Let me ask—

Chairman THOMAS. I believe, in looking at the chart, that they are not justified for inflation, they are nominal dollars. And at some point the Chair may put some basic ground rules in, because this is, I believe, the third chart in a row that has used nominal dollars and not adjusted dollars.

It is fine if you want to do it, but I believe for purposes of clarity we really ought to have a common yardstick.

Mr. RANGEL. Mr. Chairman, I would ask if the Secretary's figures are adjusted for inflation, because I was under the impression that we were using the same standards as the Administration was using. And if that is so, then tell them, too.

Chairman THOMAS. They did not present the chart that the gentleman from North Dakota is presenting.

Mr. RANGEL. They have been presenting a lot of charts this morning.

Chairman THOMAS. I understand that. That was six charts ago.

Mr. RANGEL. That was a small chart. He can answer it. Are you adjusted—

Chairman THOMAS. The gentleman from Louisiana? The gentleman still has not inquired. The gentleman from Louisiana.

Mr. RANGEL. Mr. Chairman, just as a matter of courtesy, you have made the point half a dozen times as to whether or not our charts are adjusted for inflation, which I thought was a very good question. I now ask, could you ask the same question for the Administration?

Chairman THOMAS. Sure.

Mr. O'NEILL. For the chart where it is appropriate to use constant dollars, we have done so. We have used nominal dollars where—for ease of explanation, we have done that.

Mr. RANGEL. We would like to adopt that answer as our own.

Chairman THOMAS. The gentleman from Louisiana.

Mr. MCCRERY. Mr. Chairman, the import of your question with respect to Mr. Pomeroy's first chart is that the nominal dollars, which is what Mr. Pomeroy's chart shows, nominal dollars, the nominal dollars are not nearly as important as the percentage of our national income that those nominal dollars represent.

And if he had put up another chart showing the rise, the estimated rise in economic growth in the country, then he would have reflected the lowest percentage of our national income represented by that national debt, that publicly held debt, since 1984 for this coming year.

And if he had followed on out as many years as he did on his chart, it would have shown the lowest percentage of national debt

as a percent of our national income since 1940, except for 1 year, 1974.

So to be honest with everybody from describing the impact of that debt, he should have put up another chart showing that juxtaposed with our national income.

Chairman THOMAS. The gentleman from Texas deserves to be heard. But prior to that, the Chair will exercise the prerogative of indicating that the elimination of the debt suddenly changed the Chairman of the Federal Reserve's testimony last year and we began to worry about it, just exactly what we would do.

I think the point of the gentleman from Louisiana is the relationship, it is the percentage of the debt to income that is most significant; and in that regard, in a bipartisan way over the last decade we have begun to move in the right direction.

Does the gentleman from Texas wish to inquire?

Mr. BRADY. I do, finally, Mr. Chairman.

Mr. Secretary, thank you for being here. I am a Houston area Congressman. Our community, our region, has been hurt very seriously by the collapse of Enron. I have neighbors who are now out of work and have lost their retirement. Politicians who try to score political points off the misery of the Enron workers cannot go any lower than they are going. They ought to be ashamed of themselves. That means you, Lloyd, and the Democratic colleagues who join in.

Mr. DOGGETT. That is really uncalled for.

Mr. BRADY. No, it is not. You are going to sit there and listen to a different message.

The message is especially important since we need to be working together to help those folks. One of the silver linings of September 11 was watching Congress pull together and unite as a country to help those who had really been hurt. The other night the President asked us to do the same thing, to help people who have been laid off from Enron, Boeing, General Motors, or any other even small business, even, in America.

The fact of the matter is since September 11, through the rest of that year, we lost almost 8,000 jobs a day. Eight thousand people had to go home every day and tell their family they are out of work, their whole lives were changed, dreams had been destroyed, everything was going bad. Things have gotten a little better, but it is still very serious.

The fact of the matter is we do agree that we need unemployment benefits for those folks who have been laid off. We agree. Unfortunately, it is still stalled in the Senate. We agree people ought to have help with health care, help with health care in the short term. Unfortunately, that is still stalled in the Senate due to politics. We agreed that families need help, we agreed that States need unemployment insurance, we agreed that people need to go back to work. Unfortunately, all of that is still stalled in the Senate due to politics.

The fact of the matter is if we do not agree on anything else, we ought to agree that if we get this economy moving, we can help those people. If we pass that stimulus plan we can help them in the short term get through things, but most importantly to get a

job, which is what they really want to get their lives back in order today.

The fact of the matter is the President's tax relief I think has helped the economy. The reason we do not have a surplus today and we are off track is Congressional spending. Some of it we need for homeland security, a good amount of it, but other of it is just needless pork barrel projects.

We have to discipline ourselves. But the biggest culprit is the economy. The only way we are going to balance the budget and start paying down the debt again, preserve Social Security and Medicare, and get people back to work is to get this economy moving now. There is no way to escape it. That is what we ought to be agreeing upon as Republicans and Democrats.

My question to you is, I know the President has more than met our leaders in the Senate halfway. I know he continues to do that. Don't we need the economic stimulus bill to pass the Senate today, just as importantly as it was back this fall?

Mr. O'NEILL. We do, and for exactly the reasons that you have given. I couldn't add anything to improve on what you have said. That is exactly right.

Mr. BRADY. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Mr. Secretary, thank you very much. You are kind to allow all of the Members to inquire. Just let the Chair say we appreciate your efforts to help us chart a course through a year that no one anticipated.

Thank you very much. Good luck.

The hearing stands adjourned.

[Whereupon, at 1:33 p.m., the hearing was adjourned.]

[Questions submitted from Mr. Neal to Secretary O'Neill, and his responses follow:]

Question 1: The Department of Treasury's explanation of the President's revenue proposals states a concern that, "The individual alternative minimum tax (AMT) may impose financial and compliance burdens upon taxpayers who were not originally intended targets of the AMT." I share your concerns. Would you explain why the Administration chose to extend only until 2004 the exemption of nonrefundable personal credits from the application of the AMT, as opposed to making this exemption permanent as were some other expiring provisions?

Question 2: Last year's enacted tax changes increased the individual AMT exemption amount by \$2000 for single filers, and \$4000 for married couples filing jointly. While your proposed budget permanently extends provisions which expire in 2010, this provision unfortunately expires at the end of 2004. If this provision is not extended, more than twice as many taxpayers will be subject to the AMT in 2005 over the prior year. Do you agree that, for millions of unsuspecting taxpayers, their taxes in 2005 will increase?

Response: The Administration's 2003 Budget proposal to extend the Tax Code provision permitting nonrefundable personal credits to be offset against the AMT for 2 years (through taxable years 2002 and 2003) is only an initial step in dealing with the AMT problem. The Administration intends to work with Congress to develop a more comprehensive approach to the AMT.

[A submission for the record follows:]

Statement of the National Society of Accountants, Alexandria, Virginia

Mr. Chairman, the National Society of Accountants (NSA) is pleased to submit testimony for the hearing record on President Bush's fiscal year 2003 budget proposals. The NSA and its affiliated state organizations represent 30,000 accountants, tax practitioners, business advisors and financial planners providing services to over

19 million individuals and small business. Most of our members are sole practitioners or partners in small to medium sized firms. NSA represents the accountants for Main Street, not the accountants for Wall Street.

IMPROVE TAX ADMINISTRATION

The Administration proposes a six-part modification to the IRS Restructuring Act of 1998 (RRA98). We concur with the provision to allow taxpayers to enter into less than full pay installment agreements with the IRS. This is a common sense provision whose implementation is long overdue. The proposal to modify IRS employee infractions subject to mandatory termination is a positive change to the RRA98.

Another proposal would curb frivolous submissions and filings by raising penalties for filing frivolous tax returns from \$500 to \$5,000 and impose a \$5,000 penalty for repeatedly filing or failure to withdraw after notice certain other submissions. While generally supportive, we caution that if improperly crafted these new measures could dampen legitimate resubmissions and filings, such as a resubmission of an Offer-In-Compromise (OIC) based on new or updated taxpayer information. In a similar vein, the proposal to terminate an installment agreement for failure to make timely tax deposits and file tax returns should contain allowances for circumstances beyond the control of the taxpayer.

We support the change that would eliminate the requirement that the IRS Chief Counsel provide an opinion for any accepted OIC equal to or exceeding \$50,000. In our view, the Chief Counsel has not added any value to the program to begin with and in fact has been a detriment to the process by withholding approval of offers on policy grounds rather than on legal sufficiency.

On the issue of the OIC program in general, NSA maintains that the program remains fundamentally flawed and ultimately no amount of "process" improvement will help. Until the program is moved from compliance oriented personnel and re-assigned to settlement oriented personnel who are allowed to design and administer a settlement oriented program, the goal of achieving what is potentially collectible at the earliest possible time and at the least cost to the government while providing taxpayers a fresh start toward future voluntary compliance will remain unfulfilled.

IRS NATIONAL RESEARCH PROGRAM

Recently, the IRS unveiled a new compliance study, known as the National Research Program, to revamp its audit selection process. As we understand the program, the tax returns of up to 50,000 individuals and small business' would be subject to review at various levels of intensity. The program would select 2000 taxpayers for detailed line-by-line examination for "calibration" purposes.

First and foremost, we do not question the right of the IRS to perform audits to ensure compliance with tax laws. Nor do we object to the need for the Service to gather statistics for use in improving the process. We do object to the perceived need to subject even 2000 taxpayers to the burden and hardship of intrusive line-by-line audits whose sole reason for selection is to satisfy a debatable statistical need for "calibration." We believe that the IRS has other tools and techniques at its disposal to gather the information needed to improve the audit process, such as data from closed cases. The IRS can and should find another way.

An audit of a tax return is by definition an adversarial process. A notice of audit from the IRS even to a compliant taxpayer is a cause for concern and anguish and many will seek, at substantial cost, professional representation to protect their interests. Adding to the mix is the fact that much of the tax code is subject to interpretation and judgment calls based on facts and circumstances. Reasonable people can and do differ on how the tax law applies to a given situation.

To defuse the adversarial aspects and to enhance taxpayer cooperation and faster resolution of issues, the IRS should grant the taxpayer limited immunity for problems discovered during the audit (barring any criminal behavior on the part of the taxpayer). If the goal of the NRP is to gather better data and truly improve the audit process then IRS should provide these taxpayers something in return for compelled cooperation as compensation for the intrusion and expense caused by these audits.

Mr. Chairman, the scars from the overly intrusive Taxpayer Compliance Measurement Program (TCMP) of the past are still fresh. We are deeply concerned, even after assurances from senior IRS management to the contrary, that this program will morph itself into an updated version of the TCMP. At the very minimum, we recommend that the Ways and Means Committee rigorously exercise its oversight authority to prevent this program from reincarnating into another TCMP nightmare.

FREE ON-LINE TAX FILING

The President's budget contains a proposal to allow taxpayers to file their taxes "free" through an IRS web site as part of the E-Government initiative. The NSA is committed to electronic filing of tax returns and in the wake of the September 11 terrorist attack issued a "Call to Arms" for its members to file returns electronically and use EFTPS for tax deposits as a means of reducing mail to the IRS service campuses. Unfortunately we must oppose the President's e-file initiative.

First, the government should not compete with the private sector. Even if the IRS starts off with a "bare bones" service, pressure will be brought to bear each year to add new features and enhancements and permit the filing of more complex returns. It also raises conflict of interest issues by having the IRS serve as tax preparer, tax collector and tax prosecutor.

Second, the initial development and on-going maintenance of an on-line filing service is expensive. This "free" service will cost taxpayers plenty. The resources of the IRS are better spent improving its woefully inadequate taxpayer service and assistance systems. It has no business in the tax return preparation industry. Even a system designed and built in "partnership" with the IRS raises cost, perception and privacy concerns.

Third, we see no market failure that requires government intervention. The private sector already provides excellent tax preparation and filing service at reasonable cost. The private sector, volunteer groups and the IRS provide a variety of free services to low-income taxpayers. The cost issue is merely a smoke screen.

Why should we spend additional money to fund a new program when it is painfully obvious that the IRS has significant difficulties even with its current programs as evidenced by a less than 75% correct response rate to taxpayer questions. In most schools, 75% is a grade of "D" and does not inspire confidence that free e-filing as envisioned in the President's budget will be successful or fair.

EXTENSION OF TIME FOR E-FILED RETURNS

The Administration proposes to extend the April filing date from April 15 to April 30 for individuals filing returns electronically to help encourage the growth of electronic filing. We sincerely doubt that this change will have any effect on getting more electronic returns filed. The early filers do so to get their refunds sooner. The procrastinators file later because they have balance due returns. Why reward them with an extra 15 days to file and pay?

To truly promote electronic filing, IRS should devote more funds to advertising of benefits to taxpayers and tax practitioners. Removing barriers that limit or discourage the practitioner community from participating as electronic return originators would also be a major step forward.

TAX CREDITS AND THE AMT TRAP

The President's budget contains a number of initiatives using tax credits, including refundable credits, to provide incentives and promote certain behavior and activities. We choose not to argue the merits of the proposals, but rather, focus on the mechanics.

Based on our reading of the description of these proposals we cannot determine how they interrelate with the alternative minimum tax. Our concern is simple: if there is no ability for a taxpayer to offset alternative minimum tax (AMT) by the "regular" tax credit the credit becomes meaningless for many taxpayers. The expansion of the AMT into the lives of middle-class Americans makes it imperative for Congress to consider the AMT implications on any new deduction and tax credit offered under the "regular" tax system and grant similar treatment under the AMT.

TAX SIMPLIFICATION

We applaud the Administration for beginning a "thorough review of means of simplifying the tax code" and developing both short term and longer-term tax simplification proposals. NSA is ready to work with the Administration, Congress and other groups to produce meaningful reform.

The Administration stated its "Highest priority will be given to simplification proposals that will yield the largest benefits, i.e. that will affect the most people and have the largest effects in reducing compliance burdens and administrative costs." We are encouraged that the Administration leads off the list with the individual AMT.

Much has been written on the adverse effect of the individual AMT and need not be restated here. We believe the individual AMT is a predator on the middle-class and the time has come for Congress to slay this monster. For every year that Congress delays action on AMT the price tag for repeal increases. In the not-to distant future the AMT will be the defacto tax system for many taxpayers undoing the

many of the benefits targeted under the regular tax for the middle class. This was never the intent of Congress.

Much of the groundwork for simplification has occurred. The recently released National Taxpayer Advocate Office 2001 report to Congress contains many important recommendations supported by NSA. Likewise, the Joint Committee on Taxation's 2001 simplification study (JCS 3-01) is a useful starting point. The Nation's taxpayers deserve a better tax system. The time has come for the political system to deliver.

